IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 528

UNITED STATES OF AMERICA,

Petitioner,

—v.—

HILTON HOTELS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

(Civil Action No. 65 C 1983)

[Caption Omitted]

DOCKET ENTRIES

(Filed Aug. 22, 1968)

November 29, 1965	Filed Complaint and four copies (JS-5) $15.00
	Filed Designation
	Issued Summons and 5 copies with 5 copies of complaint E
December 7, 1965	Filed 6 affidavits re General Rule 39 (Hilton Hotels Corporation) E
December 28, 1965	Filed summons returned served. $3.00 ht
January 28, 1966	On motion of Government, order time to answer extended to Feb. 4, 1966—Will, J Mld ntcs. 2-1-66 ht
February 3, 1966	Filed Notice of United States
February 3, 1966	Enter Order extending time for the Government to answer to and including February 28, 1966.-Robson, J
	Mld ntcs. 2-4-66 ht
February 28, 1966	Filed Answer ht

March 22, 1966	Enter Order governing procedure prior to trial and setting cause for report on May 18, 1966 at 9:15 a.m. - Draft Robson, J Mailed notices 3-23-66 ht
April 11, 1966	Ordered the following cases be and the same are transferred to Judge Lynch (65 C. 1983), Campbell, C.J., For the Executive Committee (Draft)
May 6, 1966	Filed Interrogatories by defendant to plaintiff ht
May 13, 1966	Filed Stipulation ht
May 18, 1966	Pre-trial conference held and cause continued to September 19, 1966 at 10:00 a.m. for trial. Lynch, J Mailed notices 5-19-66 ht
June 30, 1966	Filed Defendant's Answer to Interrogatories ht
September 19, 1966	By agreement, order cause continued to October 19, 1966 for trial. Lynch, J Mailed notices 9-20-66 ht
October 19, 1966	By agreement cause continued to November 21, 1966 for trial. - Lynch, J Mailed notices 10-19-66 ht
November 21, 1966	By agreement cause continued to Jan. 9, 1967 for trial - Lynch, J Mailed notice 11-23-66 r
January 3, 1967	Order cause continued from January 9, 1967 to January 10, 1967 for trial because Judge Lynch will be holding court in Freeport, Illinois on the 9th. - Lynch, J. Mailed notices 1-3-67 Y

January 10, 1967	Order cause continued to April 17, 1967 at 10 A.M. for trial. Lynch, J. Mailed notices 1-11-67 Y
April 17, 1967	Order cause held on call until April 24, 1967 10 A.M.—Lynch, J. Mailed notices 4-19-67
April 24, 1967	Order cause continued to May 8, 1967 for trial.—Lynch, J. Mailed notices 4-26-67 Y
May 8, 1967	Order cause held on trial call to May 15, 1967 at 10 A.M. - Lynch, J. Mailed notices 5-17-67 Y
June 19, 1967	Order leave to parties to file their stipulation of facts on the remaining unsettled issue by July 31, 1967 and to file their Brief simultaneously within 10 days thereafter. - Lynch, J. Mailed notices 6-20-67
July 31, 1967	Filed Second Stipulation of facts with exhibits "A" and "B" attached EOB
August 10, 1967	Filed Brief of Plaintiff. v
August 11, 1967	Filed brief for the defendant in support of its motion for summary judgment G
January 24, 1968	Filed Memorandum of Decision. (Mailed copy of Memorandum to attorneys of Record 9/24/68) Y
March 27, 1968	Enter judgment for Plaintiff and against defendant in principal amount of $26,654.48, together with $11,031-.68 of deficiency interest paid a total of $37,686.14, this total to bear interest according to law. - Draft - Lynch, J. Mailed notices 3-28-68 (JS-6) Y

May 24, 1968	Filed defendant's notice of Appeal. $5.00 US Mailed copy of notice of appeal to attorney for Plaintiff. Y
May 31, 1968	Filed Appellee's statement. Y
June 26, 1968	Enter order by agreement of the parties and with consent of the court the time in which the United States may docket its record on appeal is extended to and including August 22, 1968. - Lynch, J.
July 30, 1968	Mailed notices 6-27-68 Y Filed Defendant-Appellant's designation of complete record on Appeal. Y

[There are no docket entries in the United States Court of Appeals for the Seventh Circuit.]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[Caption Omitted]

SECOND STIPULATION

(Filed—July 31, 1967)

The parties, by counsel, stipulate that the following facts may be taken as true for the purposes of this action only. The facts stipulated to herein may be objected to at trial on the grounds of relevancy and materiality, but all other objections are waived.

9. The parties have settled the issue set forth in their original stipulation at paragraph 7(b) concerning depreciation deductions claimed by the plaintiff for the years 1955 and 1956 and plaintiff hereby dismisses its claim on that issue, and that issue alone, with prejudice.

10. Facts concerning the other issue in this case, the plaintiff's claimed deductions for the expenses of legal services which it claims it accrued in 1954, 1955, and 1956, and which were set forth in the parties' original stipulation at paragraph 7(a), are as follows:

11. Plaintiff Hilton Hotels Corporation (hereafter Hilton), a Delaware corporation, in 1949 acquired 43% of the outstanding stock of Hotel Waldorf-Astoria Corporation (hereafter, Waldorf), a New York corporation.

12. Thereafter, as a result of further acquisitions of Waldorf stock, Hilton, as of September 2, 1953, owned 325,370.5 of the 366,040.75 shares of Waldorf which were issued and not retained or held by or for the account of Waldorf.

13. The remaining 40,670.25 shares of Waldorf were owned by shareholders other than Hilton or Waldorf or parties related or connected with Hilton or Waldorf.

14. In August, 1953, Hilton had retained Standard Research Consultants, Inc., of New York City (hereafter, Standard Research), to prepare a merger study for the purpose of determining what would be a fair basis of

merger between Waldorf and Hilton, that is, the number of shares of Hilton to be exchanged in the merger for each of the 40,670.25 shares of Waldorf not held by Hilton or Waldorf.

15. On September 22, 1953, prior to the submission of its final report, Standard Research reported that a fair basis of merger would be an exchange offer of one share of Hilton common for each share of Waldorf common, and stated: "However, because of the problems incident to Hilton's control of Waldorf, together with the obvious advantages of having a wholly-owned property rather than one which has a small minority interest outstanding, we felt that Hilton would be justified in offering 1.25 shares of Hilton stock for each share of Waldorf stock held. This seems to us to be a fair basis of merger for all parties." Similarly, the final report submitted by Standard Research in October, 1953, stated that Hilton would be justified in offering 1.25 shares of Hilton common for each share of Waldorf capital stock and that such an offer would represent a fair basis of merger.

16. On November 12, 1953, an agreement of merger was entered into by Waldorf and Hilton, subject to approval of their respective shareholders as provided by law, which provided, among other things that:

> (a) Hilton shall be the surviving corporation and all of its outstanding stock shall remain outstanding after the effective date of the merger, and
>
> (b) Each share of stock of Waldorf, except shares owned by Waldorf or Hilton, at the time of filing and recording the agreement of merger "shall be converted into one and one-fourth (1¼) shares of common stock of the par value of $5.00 per share of Hilton Hotels Corporation, the Surviving Corporation. The shares of common capital stock of the par value of $1 per share of Hotel Waldorf-Astoria Corporation owned either by Hilton Hotels Corporation or Hotel Waldorf-Astoria Corporation at the time of filing and recording this agreement of merger shall be cancelled and no shares of stock or other securities shall be issued in exchange therefor."

17. On December 8, 1953, Waldorf and Hilton, by mail, notified their stockholders of meetings to be held on December 28 and 29, 1953, respectively, at which meetings the shareholders of each corporation would vote on the proposed merger of Waldorf and Hilton (a consolidation pursuant to Section 91, N.Y. Stock Corporation Law). A copy of Hilton's notice is attached hereto as Exhibit A, less pages F-1 through F-23, and pages 14 through 20 of the Agreement of Merger, which are pages of certification and execution.

18. On December 24, 1953, the holders of 19,771 shares of Waldorf, pursuant to Section 91, N.Y. Stock Corporation Law, filed, with Waldorf, their written objections to the consolidation of Waldorf and Hilton, and demanded payment for their stock; prior to the proposed vote by the shareholders of Waldorf on December 28, 1953, the holders of an additional 450 shares of Waldorf, pursuant to Section 91, N.Y. Stock Corporation Law, filed, with Waldorf, their written objections to the consolidation of Waldorf and Hilton, and demanded payment for their stock.

19. On December 28, 1953, the holders of over two-thirds of the stock of Waldorf, but not the holders of the 20,221 shares objecting, voted in favor of the merger (consolidation) of Hilton and Waldorf, and on December 29, 1953, the holders of over two-thirds of the stock of Hilton voted in favor of the merger (consolidation) of Hilton and Waldorf.

20. On December 31, 1953, the agreement of merger and the certificate of consolidation of Waldorf and Hilton were filed and recorded with the Secretary of the State of New York, pursuant to Section 91, N.Y. Stock Corporation Law.

21. On January 7, 1954, Hilton, by mail, pursuant to Section 21, Subdivision 1, N.Y. Stock Corporation Law, offered to the objecting holders of the 20,221 shares of Waldorf a payment of $24.54 for each share of Waldorf. The offer referred to was rejected by the holders of the 20,221 shares of Waldorf and they began proceeding pursuant to Section 21, N.Y. Stock Corporation Law, on February 11, 1954, in the Supreme Court, in and for the

County of New York, for a determination of the value of their 20,221 shares of Waldorf.

22. Pursuant to the provisions of Section 21, N.Y. Stock Corporation Law, on February 25, 1954, an appraiser, Alfred Ratheim, was appointed by the court to appraise the value of the capital stock of Waldorf as of December 27, 1953; pursuant to Section 21, value is to be determined as of the close of business on the day before the stockholders' vote to which objection has been made.

23. After December 31, 1953, but prior to May, 1954, Hilton asked Standard Research to determine the value of the common stock of Waldorf as of December 27, 1953. This included the preparation of charts and tables supporting its opinion as to that value and the providing of testimony at hearings in the appraisal proceedings in New York before the court appointed appraiser.

24. Hearings were held at New York on May 4, July 19, 20, 21, 27, 28, and 29, and on August 2 and 3, 1954. At those hearings the corporation and the various dissenting stockholders were represented by counsel as follows:

> The corporation appeared by Paul, Weiss, Rifkind, Wharton & Garrison, Esquires, Simon H. Rifkind and Paul J. Newlon, Esquires, of counsel.
>
> Evelyn C. Austin, et al. appeared by Hodges, Reavis, McGrath, Pantaleoni & Downey, Esquires, and Herman W. Finkelstein, Esquire, Martin D. Jacobs, Dennis B. Sullivan and Herman W. Finkelstein, Esquires, of counsel.
>
> Frieda S. Blumenthal and Kate Hurwitz appeared by Morris B. and Daniel W. Blumenthal, Esquires, Daniel W. Blumenthal and Benjamin Hurwitz, Esquires, of counsel.
>
> There was no appearance on behalf of petitioners Reuben Epstein and Mortimer H. Epstein.

1235 pages of testimony were taken, 31 exhibits marked in evidence or for identification on behalf of the corporation, and 24 exhibits marked in evidence or for identification on behalf of the petitioning stockholders.

The corporation called as witnesses: Mr. Joseph Paterson Binns, the Executive Vice-President, General Manager and a Director of Hotel Waldorf-Astoria Corporation; Mr. Gustave Killenberg, a certified public accountant, who was a general partner of the accounting firm of Harris, Kerr, Forster & Co., a firm specializing in hotel accounting, and who was employed by Hotel Waldorf-Astoria Corporation to audit its books; and a Mr. Eugene S. Merrill, Executive Vice-President of Standard Research Consultants.

The petitioners called as witnesses: Mr. Gustav A. Gomprecht, a certified public accountant and a partner in the firm of Main & Co., of New York City; Mr. William MacRossie, an appraiser and a member of the firm of William A. White & Sons, of New York City; Mr. Wallace A. True, real estate and financial advisor to the United Artists Theatre Circuit; and a Mr. Hyman Adelsberg, an appraiser.

After the hearing briefs and reply briefs were submitted on behalf of all parties.

25. The proceedings in the Supreme Court of New York were terminated by an order of that Court on June 14, 1955, which, upon and pursuant to a June 13, 1955 stipulation of settlement and dismissal by and between all of the parties, decreed that Hilton would issue and deliver to each petitioner five-eighths of one share of Hilton common stock for each share of stock of Waldorf held by such petitioner, but without any fractional shares being issued, Hilton to pay $6 for each one-eighth share of Hilton common stock which would otherwise be required to be issued as a fractional share. The Hilton stock was to be issued and delivered against the surrender to Hilton of the certificate or certificates representing the Waldorf stock held by each petitioner, duly endorsed in blank and in proper form for transfer and accompanied by evidence of payment of all requisite stock transfer taxes, if any.

26. The Court approved settlement referred to in paragraph 25 was accomplished in 1955 upon the issuance of 12,621 shares of Hilton common stock and cash payments totalling $822 in lieu of fractional shares, all in

exchange for the 20,221 shares of Waldorf stock held by the dissenters to the merger.

27. In 1954 and 1955, Hilton accrued the following amounts which it paid in connection with the appraisal proceedings under Section 21, Subdivision 1, N.Y. Stock Corporation Law, instituted by the dissenting Waldorf shareholders:

1954:		
Legal services of Paul, Weiss, Rifkind, Wharton and Garrison in the appraisal proceedings	$15,000.00	
Services of Joseph VanGelder and Samuel S. Sklarew as court reporters in appraisal proceedings on July 19-21, July 27-29, and August 2-3, 1954	2,258.62	
		$17,258.62
1955:		
Services of Alfred Ratheim as court appointed appraiser from May 4, 1954 to August 3, 1954	$12,500.00	
Legal services of Paul, Weiss, Rifkind, Wharton and Garrison in the appraisal proceedings	10,000.00	
		$22,500.00

28. In 1956, Hilton accrued $17,500 which it paid to Standard Research on March 20, 1956 for services relating to:

(a) the original report of Standard Research relating to to fair basis of merger submitted in October, 1953, and described in Paragraph 15, and

(b) the services of Standard Research rendered after December 31, 1953, with respect to the appraisal proceeding in New York described in Paragraph 23.

29. As shown in Exhibit B, attached hereto, Standard Research valued its services for its report on the fair basis of merger at $8,289 and its services with respect to the appraisal proceeding at $16,074, and requested payment of a total of $24,363 from Hilton. The amount of this bill was settled for $17,500 by a compromise between Hilton and Standard Research in 1956.

30. The amounts described in paragraphs 27 and 28 were finally determined in the years 1954, 1955, and 1956 as set forth in those paragraphs.

31. Upon decision, the parties will compute the amount of any judgment which may be due, if decision is for the taxpayer. If they are unable to agree on such computation, the matter will be submitted to the Court. If decision is for the defendant, the complaint should be dismissed.

/s/ MILTON A. LEVENFELD
Attorney for Plaintiff

/s/ EDWARD V. HANRAHAN
United States Attorney
Attorney for Defendant

PROXY STATEMENT FOR SPECIAL MEETING OF STOCKHOLDERS

To Be Held on December 29, 1953.

The enclosed proxy is solicited by and on behalf of the management of Hilton Hotels Corporation to be used at a special meeting of stockholders to be held at the offices of the corporation in the Conrad Hilton Hotel, 720 South Michigan Avenue, Chicago, Illinois, on December 29th, 1953, and at any adjournment thereof. All shares represented by proxies will be voted at the meeting. Any stockholder giving a proxy may revoke the same at any time prior to the voting of such proxy.

As of November 16, 1953, the corporation had outstanding (excluding treasury stock) 1,539,815 shares of Common Stock and 25,312 shares of Convertible Preference Stock. The holders of Convertible Preference Stock and Common Stock are entitled to one vote for each share at meetings of the stockholders. The favorable vote of stockholders holding two-thirds of the corporation's outstanding stock is necessary for the adoption of the merger agreement hereinafter referred to. The stock transfer books will not be closed but, as ordered by the Board of Directors, only stockholders of record at the close of business on November 30th, 1953, will be entitled to vote at the meeting.

PROPOSED MERGER WITH HOTEL WALDORF-ASTORIA CORPORATION

Hotel Waldorf-Astoria Corporation, a New York corporation (hereinafter referred to as Waldorf) has leased and operated the Hotel Waldorf-Astoria in New York City since it was erected in 1931. Waldorf is a majority owned subsidiary of Hilton Hotels Corporation (hereinafter referred to as Hilton or as the Corporation). Hilton first acquired an interest in Waldorf on October 14, 1949, when a syndicate in which it participated purchased at $12 per share a closely held block of 249,024 shares of Waldorf's common stock constituting 68% of the 366,040¾ shares outstanding; Hilton participated in the

syndicate to the extent of purchasing 157,325 shares. Since then 168,045½ additional Waldorf shares have been acquired by Hilton as a result of the exercise by Hilton of its options to purchase shares from other syndicate participants at their cost, exchange of Hilton shares for Waldorf shares on a share-for-share basis with syndicate members and other Waldorf stockholders, market purchases and purchases pursuant to an invitation for tenders to all other Waldorf stockholders. As a result, the Corporation now owns a total of 325,370½ shares out of 366,040¾ outstanding shares, or 88.89% of the issue.

It has been the considered judgment of the Directors of the Corporation for some time that ultimately the Hotel Waldorf-Astoria should be integrated into the Hilton system through a fair and equitable merger plan which would finally and definitively settle the relationship of this corporation to the minority interests in Waldorf through a fair stock allocation, thus eliminating an outstanding minority interest in a single hotel property and avoiding any problems with minority interests which might arise or be thought to arise as a result thereof and achieving the economies in administrative, supervisory and corporate expenses and the increased efficiency which will accompany the full integration of the Hotel Waldorf-Astoria into Hilton Hotels Corporation. The Board of Directors of both corporations have given careful consideration to the details of such a merger plan and a fair and equitable basis for the allocation of securities thereunder. An independent firm, Standard Research Consultants, specializing in this field, was retained to make a complete study and investigation into the matter and render a report on a fair and equitable basis for a merger and allocation of securities. After extended review and consideration of the report and other data, the directors of both corporations have approved the merger terms herein set forth and the necessary resolutions to consummate the merger plan have been adopted by both Boards, subject to ratification of the plan and the authorization of its consummation by the stockholders of both corporations, and subject to the discretionary right of the Directors of both corporations to terminate the

merger agreement at any time prior to the effective date of the merger if of the opinion that the merger is in all the circumstances, including dissents filed by the stockholders of either or both corporations, impractical or undesirable. After consideration of the full details of the plan at the special meeting of the stockholders of this corporation convened to consider it, the management will recommend that the stockholders of this corporation ratify and approve the plan and authorize its consummation.

Since Hilton is a Delaware corporation and Waldorf is a New York corporation, the merger plan and all instruments and details in connection with the consummation of it must comply with the requirements of the corporation laws of both States. An immaterial technical difference in terminology exists under the laws of the two states. Under the corporation law of Delaware applicable to Hilton, the proposed transaction is termed a merger, whereas under the law of New York applicable to Waldorf it is technically termed a consolidation under § 91 of the Stock Corporation Law of the State which provides, however, that if one of the constituent companies survives, the transaction is equivalent in legal effect to a merger of such corporations. For convenience of reference and terminology in this Proxy Statement, the proposed transaction is referred to as a merger.

BRIEF SUMMARY OF TERMS OF MERGER

Under the agreement of merger, a copy of which is attached hereto as Exhibit A, all of the assets of Waldorf will be acquired by Hilton and all of its liabilities will be assumed by Hilton. Each share of common stock of Waldorf will be changed into a share and one-quarter of common stock of Hilton, except the shares of common stock of Waldorf held by Hilton on the effective date of the merger which shares will be cancelled. No change will be made in the terms, provisions or rights applicable to the outstanding shares of convertible preference and common stock of Hilton or to any shares of First Preferred Stock of Hilton which may be outstanding on such effective date.

No fractional shares will be deliverable upon consummation of the merger but in lieu thereof the Corporation will issue non-dividend bearing and non-voting scrip. Such scrip will be exchangeable for full common shares when combined with other like scrip on or before December 31, 1955. As soon as practicable thereafter the remaining full shares held for issuance upon surrender of the scrip will be sold in the open market and the proceeds thereof will until December 31, 1959 be distributed pro-rata upon surrender of the remaining scrip certificates.

Since there are outstanding 40,670¼ shares of common stock of Waldorf held by others than Hilton the number of outstanding shares of Hilton will be increased under the one and one-quarter for one conversion ratio to the extent of 50,838 shares. This number may, however, be decreased in view of the rights of dissenting stockholders to have their shares appraised and purchased.

No changes will be made in the charter or by-laws of Hilton which will continue as the charter and by-laws of the surviving corporation. No changes will be made in the officers or directors of Hilton by reason of the merger.

DISCRETIONARY AUTHORITY

The merger agreement may be terminated and, in such event, shall become void and of no effect in the event the Board of Directors of Hilton or Waldorf at any time prior to the effective date of the merger is of the opinion that the merger is, under all the circumstances, including the dissents filed by the stockholders of either Hilton or Waldorf, impracticable or undesirable.

LISTING AND REGISTRATION

The outstanding Common Stock of Hilton is listed on the New York Stock Exchange, Los Angeles Stock Exchange and San Francisco Stock Exchange and is registered under the Securities and Exchange Act of 1934. Application will be made for such listings and registration of the additional shares of Common Stock of Hilton issueable under the merger agreement.

TAX STATUS OF THE MERGER

Both Hilton and Waldorf have been advised by their respective counsel that in their opinion, under the applicable provisions of the Internal Revenue Code now in effect, no taxable gain or loss will be realized by stockholders of either Hilton or Waldorf as a result of the merger except in the case of such stockholders who have objected to the merger and are paid the value of their stock in proceedings pursuant to applicable state law.

The companies have been advised that the basis of the Hilton common stock in the hands of former holders of Waldorf stock will be the same as the cost or other basis of the Waldorf stock surrendered in exchange therefor.

RIGHTS AND REMEDIES OF DISSENTING STOCKHOLDERS

As to Hilton

Hilton is a Delaware corporation. Section 61 of the General Corporation Law of the State of Delaware provides, among other things, that the corporation surviving a merger shall within ten days after the date on which the agreement of merger has been filed and recorded, notify each stockholder of a merging Delaware corporation, at his last known address as appears on the books of the corporation, who objected to the merger in writing and whose shares were not voted in favor of such merger and who filed such written objections with the corporation before the taking of the vote on such merger, that the agreement of merger has been filed and recorded; and if any such stockholder shall within twenty days after the date of mailing of said notice demand in writing from the resulting corporation payment of his stock, then the resulting corporation shall, within thirty days after the expiration of such period of twenty days, pay to him the value of his stock on the date of the recording of the merger agreement, exclusive of any element of value arising from the expectation or accomplishment of such merger; and if during such thirty-day period the resulting corporation and such stockholders shall fail to agree as to the value of such stock, any such stockholder or

the resulting corporation may, by a petition filed in the Delaware Court of Chancery within four months after the expiration of said thirty-day period, demand a determination of the value of the stock of all such stockholders by an appraiser to be appointed by such Court. Voting against, or a direction in a proxy to vote against, the adoption of the agreement of merger will not constitute an objection in writing under the purview of said Section 61.

As to Waldorf

Waldorf is a New York corporation. Section 91 of the New York Stock Corporation Law provides that any stockholder of Waldorf not voting in favor of the merger may object to the merger and demand payment for his stock at any time prior to the vote. The objection and demand must be in writing and filed with Waldorf. The objecting stockholder of Waldorf shall have the right to have such stock appraised and paid for in the manner provided and subject to the conditions imposed in Section 21 of the New York Stock Corporation Law. In general said Section 21 provides that within ten days after the vote is taken the surviving corporation shall make a written offer personally or by registered mail to each objecting stockholder to pay for his stock at a price deemed by the surviving corporation to be the value thereof. If the surviving corporation fails to make an offer within the specified time or if the objecting stockholder fails to accept such offer within 20 days after the mailing or delivery thereof, either the surviving corporation or the stockholder may petition the Supreme Court of New York County to determine the value of the stock, such petition to be returnable on the fiftieth day after a vote is taken. The Court will then proceed to determine the value of the stock or appoint an appraiser to do so. In the latter event the appraiser will take testimony and file a report giving conclusions as to the value of the stock and the reasons therefor which the Court may confirm, reject or modify. The surviving corporation will then be required to purchase the shares at the price determined upon. Voting against, or a di-

rection in a proxy to vote against, the proposal to approve the merger agreement will not constitute an objection in writing as required by said Section 91.

THE MANAGEMENT RECOMMENDS THAT THE STOCKHOLDERS VOTE TO APPROVE THE MERGER.

GENERAL

The cost of preparing and mailing the notice of the meeting, proxy statement and form of proxy will be paid by Hilton. In addition to mailing copies of this material to all stockholders, Hilton will request banks and brokers to forward copies of such material to persons for whom they hold stock of Hilton and to request authority for execution of the proxies. Hilton will reimburse such banks and brokers for their out-of-pocket expenses incurred in connection therewith, which out-of-pocket expenses it is estimated will not exceed $250.

If matters other than those for which authority is herein sought should arise at the meeting, it is intended that the shares represented by the proxies will be voted in the discretion of the persons named therein. The management has no knowledge of any other matters that may be presented to the meeting.

All valid proxies which may be received will be voted unless previously revoked and, if specification is made upon any proposition to be voted upon as set forth therein, in accordance with such specification.

The Proxy Statement includes the financial statements listed on page F-1. The statements of both Hilton and Waldorf at December 31, 1952, are audited and certified by independent public accountants. The statements as of September 30, 1953, are based upon unaudited figures of the companies.

Additional financial statements of Hilton and Waldorf are on file with the Securities and Exchange Commission, Washington, D. C., and with the New York Stock Exchange and, in the case of Waldorf, with the American Stock Exchange.

By order of the Board of Directors.
WILLIAM J. FRIEDMAN
Secretary.

AGREEMENT OF MERGER

Pursuant to Section 252 of the General Corporation Law of the State of Delaware

Between

HILTON HOTELS CORPORATION

and

HOTEL WALDORF-ASTORIA CORPORATION

AGREEMENT OF MERGER dated as of the 12th day of November, 1953, made by and between HILTON HOTELS CORPORATION and its Board of Directors, party of the first part, a corporation organized and existing under and by virtue of the laws of the State of Delaware, and HOTEL WALDORF-ASTORIA CORPORATION and its Board of Directors, party of the second part, a corporation organized and existing under and by virtue of the laws of the State of New York,

WITNESSETH, That:

WHEREAS, the two corporations deem it advisable that Hilton Hotels Corporation, party of the first part, merge into itself Hotel Waldorf-Astoria Corporation, party of the second part, and Hotel Waldorf-Astoria Corporation, party of the second part, should be merged into Hilton Hotels Corporation, party of the first part, and that said corporations should be consolidated with each other so as to form a single corporation which shall be Hilton Hotels Corporation, as authorized under and pursuant to the terms and conditions hereinafter set forth; and

WHEREAS, said Hilton Hotels Corporation has been duly organized under and by virtue of the General Corporation Law of the State of Delaware pursuant to an Agreement of Consolidation which was filed in the office of the Secretary of State on May 29, 1946, and a certified copy thereof recorded in the office of the Recorder of Deeds for the County of New Castle, State of Delaware, on May 29, 1946, and was authorized to do busi-

ness in the State of New York by certificate of authority issued on May 31, 1946 by the Department of State of the State of New York; and

WHEREAS, Hilton Hotels Corporation has an authorized capital consisting of 4,446,495.03 shares, of which 100,000 shares are First Preferred Stock of the par value of $100 per share, 346,495.03 shares are Convertible Preference Stock of the par value of $50 per share, and 4,000,000 shares are Common Stock of the par value of $5 per share, and has now outstanding 213,426 shares of 4% Convertible Preference Stock and 1,755,807 shares of Common Stock (the term "outstanding", as used in this instrument, to include shares of any corporation held in its own treasury); and

WHEREAS, the said Hotel Waldorf-Astoria Corporation has heretofore been duly organized under and by virtue of the Stock Corporation Law of the State of New York, the certificate of incorporation of which was filed in the Department of State of the State of New York on May 28, 1929; and

WHEREAS, said Hotel Waldorf-Astoria Corporation has an authorized capital consisting of 386,380 shares of common capital stock of the par value of $1 per share, of which 366,380 shares are now outstanding; and

WHEREAS, the principal office of Hilton Hotels Corporation is located at 129 South State Street in the City of Dover, County of Kent, State of Delaware, and the name and address of its registered agent is United States Corporation Company, 129 South State Street, Dover, Delaware; and the principal office of Hotel Waldorf-Astoria Corporation is located at the Hotel Waldorf-Astoria, 49th Street and Park Avenue, Borough of Manhattan, City, County and State of New York.

Now, THEREFORE, the corporations, parties to this Agreement of Merger, by and between their respective Boards of Directors, have agreed and hereby agree, each with the other, that Hotel Waldorf-Astoria Corporation, party of the second part, be merged with and into Hilton

Hotels Corporation, party of the first part, and that said corporations be consolidated with each other so as to form a single corporation which shall be Hilton Hotels Corporation, pursuant to the laws of the States of Delaware and New York and do hereby agree upon and prescribe the terms and conditions of said merger and consolidation (hereinafter referred to as the "merger") and carry the same into effect, as follows:

FIRST: Hilton Hotels Corporation, party of the first part, merges into itself Hotel Waldorf-Astoria Corporation, party of the second part, and Hotel Waldorf-Astoria Corporation shall be and hereby is merged into Hilton Hotels Corporation, and said corporations, the party of the first part and the party of the second part are hereby consolidated with each other so as to form a single corporation which shall be Hilton Hotels Corporation, it being the intention of the parties that the said Hilton Hotels Corporation shall continue as the surviving corporation and retain its corporate existence as prior to the merger.

SECOND: Upon this merger becoming effective, the separate existence of Hotel Waldorf-Astoria Corporation shall cease and Hilton Hotels Corporation, into and with which Hotel Waldorf-Astoria Corporation shall have been merged as provided herein, shall continue to exist as the surviving corporation (herein called "Surviving Corporation"), and without further action shall possess all the rights, privileges, powers and franchises of a public as well as of a private nature, and shall be subject to all the restrictions, disabilities and duties of each of the constituent corporations to this merger, and all property, real, personal and mixed, and all debts due to each of said constituent corporations, for whatever account, whether for stock subscriptions or otherwise, as well as all other things and actions belonging or accruing to each of said constituent corporations shall be vested in Hilton Hotels Corporation, the Surviving Corporation; and all property, rights, privileges, powers and franchises, and all and every other interest, shall be thereafter as effectually the property of Hilton Hotels Corporation, the

Surviving Corporation, as they were of said constituent corporations; and the title to any real estate, whether by deed or otherwise vested in either of said constituent corporations, shall not revert or be impaired by reason of this merger; provided that all rights of creditors and all liens upon the property of either of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of Hotel Waldorf-Astoria Corporation shall thenceforth attach to Hilton Hotels Corporation, the Surviving Corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

Pursuant to Section ninety-one of the Stock Corporation Law of the State of New York, Hilton Hotels Corporation hereby agrees that it may be sued in the State of New York for any obligation of Hotel Waldorf-Astoria Corporation and hereby irrevocably appoints the Secretary of State of the State of New York as its agent to accept service of process in an action for the enforcement of payment of such obligations.

THIRD: The terms and provisions of the Agreement of Consolidation of Hilton Hotels Corporation referred to in the preambles hereof, as amended subsequent to the filing and recording thereof, shall constitute the charter and the certificate of incorporation of Hilton Hotels Corporation, the Surviving Corporation, and the terms and provisions thereof are hereby incorporated herein with the same force and effect as though herein set forth in full, and from and after the effective date of this agreement of merger and until amended as provided by law, said Agreement of Consolidation, as amended subsequent to the filing and recording thereof, separate and apart from this agreement of merger, may be separately certified as the charter of Hilton Hotels Corporation, the Surviving Corporation. In addition to the powers conferred upon it by statute, Hilton Hotels Corporation, the Surviving Corporation, shall have the powers set forth in, and except as otherwise provided by law, shall be governed by said Agreement of Consolidation.

FOURTH: The mode of carrying into effect the merger provided for in this agreement of merger and the manner and basis of converting the shares of the constituent

(Duplicate)

corporations into shares of the Surviving Corporation, shall be as follows:

(a) Each issued and outstanding share of 4% Convertible Preference Stock and of Common Stock of Hilton Hotels Corporation, and if any shares of First Preferred Stock of Hilton Hotels Corporation shall be issued after the date hereof and shall be outstanding at the time of filing and recording this agreement of merger, shall remain outstanding, and each issued and outstanding share of common capital stock of the par value of $1 per share of Hotel Waldorf-Astoria Corporation, except such shares owned either by Hilton Hotels Corporation or Hotel Waldorf-Astoria Corporation at the time of filing and recording this agreement of merger, shall be converted into one and one-fourth (1¼) shares of Common Stock of the par value of $5 per share of Hilton Hotels Corporation, the Surviving Corporation. The shares of common capital stock of the par value of $1 per share of Hotel Waldorf-Astoria Corporation owned either by Hilton Hotels Corporation or Hotel Waldorf-Astoria Corporation at the time of filing and recording this agreement of merger shall be cancelled and no shares of stock or other securities shall be issued in exchange therefor.

No fractional shares of Common Stock of Hilton Hotels Corporation shall be issued or become issuable hereunder, and the holders of common capital stock of Hotel Waldorf-Astoria Corporation shall not be or become entitled to any fractional shares of Common Stock of Hilton Hotels Corporation by reason of the conversion referred to above. If rights to fractions of a share of Common Stock of Hilton Hotels Corporation would result from such conversion, Hilton Hotels Corporation shall, for and in lieu of each such fraction of a share, issue and deliver

to the holder entitled thereto, a scrip certificate for such fraction of a share of Common Stock of Hilton Hotels Corporation, which scrip certificate, when surrendered on or before December 31, 1955, together with one or more other scrip certificates for a fraction or fractions of a share of Common Stock of Hilton Hotels Corporation, (similarly exchangeable at the time of surrender) and equal in the aggregate to one or more full share or shares of such Common Stock, shall entitle the bearer to receive from Hilton Hotels Corporation in exchange therefor (i) a certificate or certificates for Common Stock of Hilton Hotels Corporation for the full share or shares represented in the aggregate by such surrendered scrip certificates, and (ii) a new scrip certificate for any fraction of a share of such Common Stock, as the case may be, in excess of the number of whole shares of such stock specified by the scrip certificates so surrendered. Such scrip certificate shall not entitle any bearer thereof to any dividend or voting rights or any other powers or rights of a stockholder of Hilton Hotels Corporation, all holders of such scrip certificates being hereby limited to such powers and rights only as are by this paragraph expressly conferred. All rights in and under such scrip certificates shall be vested solely in the bearers of such scrip certificates and shall pass by delivery thereof, and Hilton Hotels Corporation shall be entitled to treat each bearer of a scrip certificate as the owner thereof for all purposes and shall be unaffected by any notice to the contrary. The issue and delivery by Hilton Hotels Corporation to the bearers of such certificates of one or more stock certificates and a scrip certificate for any excess fraction of a share, pursuant to the terms and conditions in this paragraph set forth, shall constitute a full and complete discharge of all liability of Hilton Hotels Corporation under such a scrip certificate, and, by receiving and accepting any such scrip certificate or scrip certificates, each successive bearer thereof consents to and shall be bound by the terms and conditions

contained in this paragraph, which shall be set forth in or on the back of said scrip certificates. The Board of Directors of the Hilton Hotels Corporation is hereby authorized to make and enforce any and all such regulations, not inconsistent herewith, governing the issue and manner of surrender and exchange of scrip certificates hereunder, as such Board of Directors in its discretion may deem advisable. All shares of Common Stock issued pursuant to the provisions of this paragraph shall be fully paid and non-assessable. Each and all of such scrip certificates shall not be exchangeable for shares of Common Stock unless surrendered for exchange as in this paragraph provided on or before December 31, 1955. As soon as practicable after December 31, 1955, the remaining full shares held for issuance upon surrender of scrip certificates on or before December 31, 1955, will be sold in the open market and the proceeds will, until December 31, 1959, be distributed pro rata upon surrender of unexchanged scrip certificates. After December 31, 1959, the holders of unexchanged scrip certificates shall not be entitled to any pro rata distribution of such proceeds, and such scrip certificates shall become and be void and of no value. Any proceeds resulting from such sale, not claimed on or prior to December 31, 1959, shall be held by Hilton Hotels Corporation as part of its general funds free of any claims of holders of scrip certificates.

(b) After the effective date of merger, each owner, except Hilton Hotels Corporation and Hotel Waldorf-Astoria Corporation, of an outstanding certificate representing shares of common capital stock of Hotel Waldorf-Astoria Corporation shall be entitled, upon surrendering such certificate or certificates to Hilton Hotels Corporation, the Surviving Corporation, to receive in exchange therefor a certificate or certificates representing the shares of Common Stock of Hilton Hotels Corporation, the Surviving Corporation, into which the shares of stock theretofore represented by the surrendered certificate or certifi-

cates shall have been converted, and a scrip certificate for fractional shares, if any, as hereinabove in paragraph (a) of this clause Fourth provided. Until such surrender and exchange, no stockholder shall, however, be entitled to dividends upon or to vote the shares of Common Stock of Hilton Hotels Corporation, the Surviving Corporation, to which he is entitled as a result of the merger. Upon such surrender and exchange, all dividends declared on the Common Stock of Hilton Hotels Corporation, the Surviving Corporation, after the effective date of the merger and before the issuance of the new certificates for shares of Common Stock of Hilton Hotels Corporation, the Surviving Corporation, so issued in exchange, will be paid upon the issuance of such new certificates.

FIFTH: The by-laws of Hilton Hotels Corporation, as amended, will remain its by-laws, except to the extent that such by-laws may be inconsistent with this agreement of merger, and except as otherwise provided by law; and until altered, amended or repealed as in said by-laws provided, Hilton Hotels Corporation, the Surviving Corporation, shall be governed by the provisions thereof.

SIXTH: The number of directors of Hilton Hotels Corporation, the Surviving Corporation, shall be ten (10) until such time as a different number may be fixed by the by-laws, and such number may be altered from time to time as may be provided therein. The names and post-office addresses of the members of the first Board of Directors of Hilton Hotels Corporation, the Surviving Corporation, who shall hold office from and after the effective date of the merger until the first annual meeting of the stockholders of Hilton Hotels Corporation, the Surviving Corporation, thereafter, and until their successors shall be elected and shall have qualified according to the by-laws of Hilton Hotels Corporation, the Surviving Corporation, are as follows:

Name	Postoffice Address
CONRAD N. HILTON	9970 Santa Monica Blvd. Beverly Hills, California
HENRY CROWN	300 W. Washington St. Chicago 3, Illinois
SPEARL ELLISON	2223 El Cajon Blvd. San Diego, California
Y. FRANK FREEMAN	5451 Marathon St. Hollywood 38, California
WILLARD W. KEITH	714 W. Olympic Blvd. Los Angeles 15, California
ROBERT P. WILLIFORD	720 S. Michigan Blvd. Chicago 5, Illinois
SAM D. YOUNG	El Paso National Bank El Paso, Texas
LAWRENCE STERN	33 N. LaSalle St. Chicago 2, Illinois
CHARLES DEERE WIMAN	1325 Third Avenue Moline, Illinois
JOSEPH P. BINNS	The Waldorf-Astoria New York 22, New York

The names and postoffice addresses of the first officers of Hilton Hotels Corporation, the Surviving Corporation, who shall hold office from and after the effective date of the merger until the first meeting of the newly elected Board of Directors following the first annual meeting of the stockholders of Hilton Hotels Corporation, the Surviving Corporation, thereafter and until their respective successors shall have been elected and shall have qualified according to the by-laws of Hilton Hotels Corporation, the Surviving Corporation, are as follows:

Title	Name	Postoffice Address
President	Conrad N. Hilton	9970 Santa Monica Blvd. Beverly Hills, California
Executive Vice President	Robert P. Williford	720 S. Michigan Blvd. Chicago 5, Illinois
Vice President	Henry Crown	300 W. Washington St. Chicago 3, Illinois
Vice President	Spearl Ellison	2223 El Cajon Blvd. San Diego, California
Vice President	Joseph P. Binns	The Waldorf-Astoria New York 22, New York
Vice President	Charles L. Fletcher	720 S. Michigan Blvd. Chicago 5, Illinois
Vice President and Assistant Secretary	Lynn H. Montjoy	9970 Santa Monica Blvd. Beverly Hills, California
Secretary	William J. Friedman	208 S. LaSalle Street Chicago 4, Illinois
Treasurer and Comptroller	Herbert E. Holt	720 S. Michigan Blvd. Chicago 5, Illinois
Assistant Secretary	Joseph T. Zoline	208 S. LaSalle St. Chicago 4, Illinois
Assistant Secretary	Olive M. Wakeman	9970 Santa Monica Blvd. Beverly Hills, California
Assistant Secretary	Charles Hammer	720 S. Michigan Blvd. Chicago 5, Illinois
Assistant Secretary	J. J. Walsh	The Plaza Hotel New York 19, New York
Assistant Secretary	Fletcher Brumit	The Dayton Biltmore Dayton 2, Ohio
Assistant Secretary	C. J. Mack	The Mayflower Hotel Washington, D. C.
Assistant Secretary	Joseph A. Harper	Hotel Jefferson St. Louis, Missouri
Assistant Secretary	Maurice Rosenfield	208 S. LaSalle St. Chicago 4, Illinois
Assistant Secretary	Truett Gore	The Deshler-Hilton Columbus, Ohio

SEVENTH: The capital of Hilton Hotels Corporation, the Surviving Corporation, shall be an amount equal to the aggregate par value of all the issued shares of all

classes of its stock after giving effect to the terms and provisions of this agreement of merger. The earned surplus of Hilton Hotels Corporation plus the earned surplus of Hotel Waldorf-Astoria Corporation, except that proportion thereof accrued to the shares of stock of said corporation acquired by Hilton Hotels Corporation prior to the respective dates of acquisition of such shares, decreased by an amount equal to the excess of (a) the aggregate par value of the issued shares of all classes of stock of Hilton Hotels Corporation, the Surviving Corporation, after giving effect to the terms and provisions of this agreement of merger, over (b) the aggregate par value of the shares of stock of all classes of Hilton Hotels Corporation and Hotel Waldorf-Astoria Corporation now issued and outstanding, shall be, and shall in all respects be treated as and dealt with as earned surplus of Hilton Hotels Corporation, the Surviving Corporation.

EIGHTH: Hilton Hotels Corporation, the Surviving Corporation, shall pay all expenses of carrying this agreement of merger into effect and accomplishing the merger herein provided for.

NINTH: If at any time Hilton Hotels Corporation, the Surviving Corporation, shall consider or be advised that any further assignment or assurances in law are necessary or desirable to vest in said Surviving Corporation according to the terms hereof, the title to any property or rights of Hotel Waldorf-Astoria Corporation, the proper officers and directors of Hotel Waldorf-Astoria Corporation shall and will execute and make all proper assignments and assurances in law, and do all things necessary or proper to vest title to such property or rights in Hilton Hotels Corporation, the Surviving Corporation, and otherwise to carry out the purposes of this agreement of merger.

TENTH: The principal office of Hilton Hotels Corporation, the Surviving Corporation, will be located at 129 South State Street in the City of Dover, County of Kent, State of Delaware, and the United States Corporation Company will be the registered agent of Hilton Hotels Corporation, the Surviving Corporation, located at 129 South State Street, Dover, Delaware.

ELEVENTH: Hilton Hotels Corporation, the Surviving Corporation, hereby reserves the right to amend, alter, change or repeal its Certificate of Incorporation in the manner now or hereafter prescribed by statute, and all rights or powers conferred in such Certificate of Incorporation upon stockholders, directors and officers and on the corporation are subject to this reservation.

TWELFTH: This agreement of merger shall be submitted to each of said constituent corporations as provided by the laws of the States of Delaware and New York, and this agreement of merger shall take effect and shall be deemed and taken to be the agreement and act of merger of said corporations upon the adoption thereof by the vote by ballot, in person or by proxy, of the stockholders of each such corporation representing two-thirds of the total number of shares of its capital stock, in accordance with the requirements of the General Corporation Law of the State of Delaware, and the Stock Corporation Law of the State of New York, at a meeting of the stockholders of each of said corporations, separately called and held for the purpose of considering and voting for the adoption or rejection of this agreement of merger, and upon the doing of such other acts and things as shall be required for accomplishing the merger by the applicable provisions of said laws, provided, however, that anything herein contained to the contrary notwithstanding, this agreement of merger may be terminated by the Board of Directors of Hilton Hotels Corporation or by the Board of Directors of Hotel Waldorf-Astoria Corporation at any time prior to the effective date of the merger if either of said Boards is of the opinion that the merger is in all the circumstances, including the dissents filed by the stockholders of either or both Hilton Hotels Corporation and Hotel Waldorf-Astoria Corporation, impracticable or undesirable.

In compliance with legal requirements of the State of New York, Hotel Waldorf-Astoria Corporation and Hilton Hotels Corporation will execute and file a Certificate of Consolidation which is substantially identical with the provisions of this Agreement of Merger, except that to comply with the requirements of New York law, the

transaction is referred to as a consolidation rather than as a merger.

In the event that this agreement of merger is not adopted by the stockholders of either or both of the constituent corporations, parties hereto, in the manner specified above, or in the event of the termination by the Board of Directors of either party hereto as above provided, notice shall forthwith be given to the other party and thereupon this agreement shall become wholly void and of no effect, and there shall be no liability on the part of either party hereto or its Board of Directors or stockholders. Notwithstanding that the merger herein and the conversion of shares of the constituent corporations into shares of Hilton Hotels Corporation, the Surviving Corporation, shall occur only upon the taking of the action referred to in the next preceeding paragraph, nevertheless, whether or not such action is accomplished by December 31, 1953, for convenience in adjusting the accounts of the constituent corporations and of Hilton Hotels Corporation, the Surviving Corporation, said date of December 31, 1953, shall be deemed the date as of which the rights, privileges, powers and franchises of each of the constituent corporations and all property, real, personal and mixed, and all debts due to each of said constituent corporations, shall be vested in Hilton Hotels Corporation, the Surviving Corporation, and as of which all debts, liabilities and duties of the constituent corporations shall attach to Hilton Hotels Corporation, the Surviving Corporation, and all operations of each constituent corporation, subsequent to December 31, 1953, shall be for the account of Hilton Hotels Corporation, the Surviving Corporation.

IN WITNESS WHEREOF, a majority of the Board of Directors of each of said constituent corporations have signed this agreement of merger in its behalf and in their own behalf as such directors, and such corporations have caused these presents to be signed in their behalf by their respective Presidents or Vice-Presidents and have caused their respective corporate seals to be hereunto affixed and attested by their respective Secretaries or Assistant Secretaries, all as of the day and year first above written.

A majority of the Board of Directors of Hilton Hotels Corporation

HILTON HOTELS CORPORATION

By .....
CONRAD N. HILTON, President

Attest:

.....
WILLIAM J. FRIEDMAN, Secretary

A majority of the Board of Directors of Hotel Waldorf-Astoria Corporation

HOTEL WALDORF-ASTORIA CORPORATION

By .....
JOSEPH P. BINNS,
Executive Vice President

Attest:

.....
FRANCIS T. DE VINCENT, Assistant Secretary

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UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

[Caption Omitted]

MEMORANDUM OF DECISION

(Filed—January 24, 1968)

One of the two issues in this case has been settled. Remaining for decision in this case is the plaintiff's claim for deductions for certain legal services accrued in 1954, 1955, and 1956.

The facts concerning the disputed issue are contained in the parties' second stipulation and are adopted by this court as its findings of fact.

It is clear to this court—and taxpayer now concedes in its brief—that the taxpayer is not entitled to a deduction for that portion of the 1956 payment to Standard Research which was for services by Standard Research in determining a fair basis of merger between Waldorf and Hilton. (Paragraphs 14 and 15 of the second stipulation.) Expenses incurred in reorganizing or recapitalizing a corporation are not deductible as ordinary and necessary business expenses. General Bancshares Corp. v. CIR, 326 F2d 712 (8th Cir., 1964); Gravois Planning Mill Company v. CIR 299 F2d 199 (8th Cir., 1962); Missouri-Kansas Pipe Line Co. v. Commissioner, 148 F2d 460, 462 (3 Cir., 1945).

The only issue therefore is whether those expenses incurred by the taxpayer in connection with the appraisal proceeding are deductible.

In reaching a decision the court must consider the primary purpose of the expenditures involved, and deductibility must not be denied merely because a question of title to property is incidentally involved. Rassenfoss v. Commissioner, 158 F2d 764, (7th Cir., 1966).

Under Section 91(9) of the New York Stock Corporation Law the merger became effective when the Certificate of Consolidation was filed in the office of the Secretary of State. Section 91 provides that the objecting shareholders shall have the right to have their stock appraised

and paid for in the manner provided, and subject to the conditions imposed by Section 21 of the New York Stock Corporation Law.

Section 21(6) provides:

> "Any stockholder demanding payment for his stock shall have no right to receive any dividends or distributions payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights as a stockholder of the corporation in respect to such stock, except the right to receive payment for the value thereof as in this section provided . . ."

Section 21(7) provides that if the objecting stockholder demands payment as a result of action taken pursuant to Section 91, then:

> ". . . the shares or other securities of the resulting or surviving corporation into which the shares of the objecting stockholder would have been converted had no objection been made shall, unless the certificate of merger or consolidation shall otherwise provide, be deemed to have been duly issued in accordance with the terms of such certificate and reacquired by the resulting or surviving corporation, and may be held or disposed of by it free of any preemptive rights of stockholders."

This court agrees with the reasoning expressed in Smith Hotel Enterprises, Inc. v. Nelson, 236 F. Supp. 303, (D.C.E.D. Wisconsin, 1964) wherein Judge Grubb held, in an analogous situation, that the taxpayer was entitled to a deduction. In that case the corporation received an offer to purchase substantially all of its assets. At a stockholders meeting, two of the three stockholders voted to accept the offer, but the third dissented and demanded payment from the corporation of the fair value of her shares pursuant to the Wisconsin statutes setting out the rights of dissenting shareholders in the event of the sale of all or substantially all of the prop-

erty and assets of a corporation. The fair value of the shares was determined by the Circuit Court of Milwaukee, and the corporation deducted its legal and other expenses incurred in connection with the litigation. The District Director of Internal Revenue disallowed the deduction on the grounds that the expenses incurred in the litigation were capital expenditures made for the acquisition of the shares owned by the dissenting shareholder.

The United States District Court in the Smith case held the expenses deductible as ordinary and necessary business expenses. Judge Grubb noted that under the Wisconsin law the corporation was required to purchase the stock of the dissenting shareholder and that the only purpose of the action in Circuit Court was to determine the fair value of the shares.

The opinion in the Smith case stated:

> ". . . it appears that the primary purpose of the state litigation in the instant case was a determination of the fair value of the shares, and the involvement of title was incidental. The deduction made by the taxpayer was proper as an ordinary and necessary business expense."

Under the New York law the objecting stockholders in the case before this court had no interest other than to receive payment for their stock. The only purpose of the appraisal proceeding was to determine the price the dissenting stockholders were to be paid. The merger was already effective and the expenses incurred by the corporation in the appraisal proceeding were not reorganization expenses. It would not be proper to deny deductibility on the basis that the appraisal expenditures might have been foreseen as one of the consequences of the merger, any more than it would be proper to deny deductibility to expenses incurred in changing Hilton's advertising brochures to include the Waldorf-Astoria Hotel.

For the reasons stated herein the court is of the opinion that the plaintiff should prevail on the issue now being considered.

The court notes that there is some dispute remaining between the parties as to what portion of the $17,500

payment to Standard Research was in connection with services relating to the fair basis of the merger, and what portion was in connection with services relating to the appraisal proceeding. The former expenses are not deductible; the latter are.

As stated in the second stipulation, the parties will compute the amount of any judgment which may be due. When the parties have reached agreement an appropriate judgment order should be submitted to the court. If the parties are unable to agree as to what portion of the payment to Standard Research is deductible, the issue may then be submitted to the court for determination.

/s/ WILLIAM J. LYNCH
Judge, United States District Court

Dated: Jan. 24, 1968

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[Caption Omitted]

JUDGMENT ORDER

Pursuant to this Court's Memorandum of Decision it is ordered that judgment in this cause be entered in favor of the plaintiff and against the defendant in the principal amount of $26,654.48 of federal income taxes paid, together with $11,031.68 of deficiency interest paid, all in the total amount of $37,686.16, this total amount to bear interest according to law. Section 6611(b)(2), Internal Revenue Code of 1954.

/s/ W. J. LYNCH
Judge, United States District Court

Dated: March 27, 1968

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IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1968—JANUARY SESSION, 1969

No. 17124

HILTON HOTELS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

April 15, 1969

Before HASTINGS, Senior Circuit Judge, and KILEY and KERNER, *Circuit Judges.*

HASTINGS, *Senior Circuit Judge.* The United States appeals from a district court decision in a refund suit brought by taxpayer Hilton Hotels Corporation (Hilton). The sole issue raised by this appeal [1] is whether the district court erred, as the Government contends, in holding that expenditures incurred by Hilton in connection with an appraisal proceeding to value the stock of dissenting shareholders in a merged corporation are currently deductible ordinary and necessary business expenses. The Government urges that such expenditures are nondeductible capital outlays.

The relevant facts were stipulated by the parties and adopted by the lower court. They may be summarized in the following manner.

On September 2, 1953, Hilton owned 325,370.5 of the 366,040.75 issued shares of the Hotel Waldorf-Astoria

[1] One of the two issues originally presented in this case was settled by the parties.

Corporation (Waldorf); the remaining 40,670.25 shares of Waldorf were owned by shareholders other than Hilton or Waldorf.

Contemplating a merger, Hilton retained Standard Research Consultants, Inc. (Standard) to prepare a merger study to determine a fair basis of exchange of Hilton stock for the remaining 40,670.25 shares of Waldorf. Standard concluded that a fair exchange ratio would be 1.25 shares of Hilton common stock for each remaining share of Waldorf stock.

On November 12, 1953, Hilton and Waldorf entered into an agreement of merger which provided that Hilton would be the surviving corporation and that 1.25 of Hilton's shares would be offered for each of the remaining 40,670.25 shares of Waldorf.

The holders of over two-thirds of the stock of Hilton and Waldorf voted in favor of the merger on December 28 and 29, 1953. Prior to this vote of approval, however, the holders of 20,221 shares of Waldorf filed with Waldorf, pursuant to § 91 of the New York Stock Corporation Law,[2] their written objections to the proposed merger and demanded payment for their stock.

On December 31, 1953, the merger agreement and the certificate of consolidation were filed and recorded with the Secretary of State of New York in accordance with the relevant provisions of § 91. Thereafter and pursuant to § 21, Subdivision 1, of the New York Stock Corporation Law[3], Hilton offered to the objecting holders of the

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[2] Section 91 reads in relevant part:

"7. Any stockholder * * * included in such consolidation, not voting in favor thereof, may object * * * and demand payment for his stock, at any time prior to the vote * * * The objecting stockholder or the corporation shall have the right to have such stock appraised and paid for in the manner provided, and subject to the conditions imposed by section twenty-one. * * *."

[3] Section 21 reads in relevant part:

"1. In the event that the stockholders of a corporation have taken action pursuant to [section] * * * ninety-one * * * and if any stockholder has objected to such action and demanded payment for his stock as provided in * * * section ninety-one * * * the corporation, * * *, shall mail * * * to such objecting

Waldorf stock a payment of $24.54 for each share of the remaining 20,221 shares. The Hilton offer was rejected, and on February 11, 1954, pursuant to § 21 [4], the dissenting holders commenced appraisal proceedings in the Supreme Court for the County of New York to determine the value of their shares of Waldorf. These proceedings continued until June 14, 1955, when the New York court approved the parties' settlement of the valuation dispute and ordered the appraisal proceedings terminated.

This suit presents the problem of characterizing for the purpose of taxation the nature of the expenses incurred by Hilton in connection with the appraisal proceeding.

It is axiomatic that if the Hilton expenditures are deemed to have been incurred, as the Government urges, in corporate reorganization or recapitalization they are not deductible. *General Bancshares Corp.* v. *C.I.R.*, 8 Cir., 326 F. 2d 712, 715, *cert. denied*, 379 U.S. 832 (1964) and cases cited therein. It is equally true, however, that if such expenditures are held to be ordinary and necessary business expenses they are deductible. Int. Rev. Code of 1954, § 162.

The line of demarcation between the deductible and the nondeductible expenditure is frequently difficult to perceive because the "* * * decisive distinctions [between the two] are those of degree and not of kind." *Welch* v. *Helvering*, 290 U.S. 111, 114 (1933). The applicable rule generally held to govern in such situations is the *primary purpose* test. *Rassenfoss* v. *Commissioner of In-*

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stockholder * * * a written offer to pay for such stock in cash at a price deemed by the corporation to be the value thereof; * * *."

[4] Section 21 reads in relevant part:

"3. If the corporation shall fail to make an offer within the time specified in subdivision one hereof, or if the objecting stockholder shall fail to accept an offer from the corporation within twenty days after the mailing * * *, either such stockholder or the corporation may petition the supreme court, at any special term thereof held within the judicial district in which the principal office of the corporation is situated, to determine the value of such stock."

ternal Revenue, 7 Cir., 158 F. 2d 764, 767 (1946); *Manufacturers Hanover Trust Co.* v. *United States*, U. S. Ct. Cl., 312 F. 2d 785, 789, *cert. denied*, 375 U.S. 880 (1963).

In the instant case, we are satisfied the district court appropriately considered and applied the primary purpose doctrine and affirm its decision which held that the Hilton expenditures, arising out of the appraisal proceedings, were deductible as ordinary and necessary business expenses. *Hilton Hotels* v. *United States*, D.C. N.D. Ill., 285 F. Supp. 617 (1968).

In reaching its decision, the district court found that the Hilton-Waldorf merger became effective under New York law upon filing the Certificate of Consolidation with the Secretary of State.[5] It further found under New York law that the objecting Waldorf holders had no interest other than to receive payment of the fair value of their stock[6] and that the *sole purpose* of the appraisal proceedings was to determine the fair value of the objecting holders' shares in Waldorf. As a result of such findings, the court concluded that the expenses experienced by Hilton in connection with such proceedings were not capital in nature and were therefore deductible as ordinary and necessary business expenses. We agree.

Like the district court, we feel that the rationale of *Smith Hotel Enterprises, Inc.* v. *Nelson*, D.C.E.D. Wisc.,

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[5] Section 91 of the New York Stock Corporation Law reads in material part:

> "9. The consolidation authorized by the provisions of this section shall become effective for all purposes of the laws of this state upon filing in the office of the secretary of state the certificate [of consolidation] * * *."

[6] Section 21 of the New York Stock Corporation Law provides:

> "6. Any stockholder demanding payment for his stock shall have no right to receive any dividends or distribution payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights of a stockholder of the corporation in respect to such stock, *except the right to receive payment for the value thereof* * * *." [Emphasis supplied.]

236 F. Supp. 303 (1964) is germane to the instant case. In *Smith*, the corporate taxpayer received an offer to purchase substantially all its assets. One shareholder objected to the offer and pursuant to the controlling state statute demanded from the corporation payment of the fair value of her shares. Failing to reach an agreement with the corporation as to the value of her shares, the dissenting shareholder petitioned the appropriate state court to determine their fair value. The taxpayer deducted, as an ordinary and necessary business expense, the expenditures it incurred in the state court valuation proceeding. The court upheld the deductibility of these expenditures upon concluding that "* * * the primary purpose of the state litigation * * * was a determination of the fair value of the shares * * *," and that the taxpayer's primary purpose in the state litigation was to keep its liability to a minimum. 236 F. Supp. *supra* at 305-306.

Upon considering the objectives of the appraisal proceeding in this case, the expenses incurred by Hilton in connection therewith should not be characterized as being capital in nature. It is apparent the proceeding was not necessary to the consummation of the merger nor did it function primarily to permit the acquisition of the objecting holders' shares. Rather, as in the *Smith* case, the paramount purpose of the appraisal proceeding was to determine the fair value of the dissenting stockholders' share in Waldorf.

Our conclusion in this case obviously is a narrow one related specifically to a factual situation controlled by New York statutes. In general, authorities cited by the Government concern circumstances distinguishable on their facts from the case at bar.

The judgment of the district court is affirmed.

A true Copy: AFFIRMED.

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit.

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

Tuesday, April 15, 1969

[Caption Omitted]

Before HON. JOHN S. HASTINGS, *Senior Circuit Judge*, HON. ROGER J. KILEY, *Circuit Judge*, HON. OTTO KERNER, *Circuit Judge*.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this day.

SUPREME COURT OF THE UNITED STATES
No. 528, October Term, 1969

UNITED STATES, PETITIONER

v.

HILTON HOTELS CORPORATION

ORDER ALLOWING CERTIORARI—Filed December 8, 1969

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted. The case is placed on the summary calendar and set for oral argument immediately following No. 412.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1970 373037 422

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In the Supreme Court of the United States

OCTOBER TERM, 1969

No.

UNITED STATES OF AMERICA, PETITIONER

v.

HILTON HOTELS CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the district court (R. 36-40)[1] is reported at 285 F. Supp. 617. The opinion of the court of appeals (Appendix A, *infra*, pp. 18-23) is reported at 410 F. 2d 194.

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[1] "R." refers to the printed record in the court of appeals entitled "Appendix".

JURISDICTION

The judgment of the court of appeals was entered on April 15, 1969 (Appendix B, *infra*, p. 24). By order dated June 30, 1969, Mr. Justice Stewart extended the time for filing a petition for a writ of certiorari to and including August 28, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether for federal income tax purposes, expenditures incurred by a corporate survivor of a merger in connection with an appraisal proceeding to fix the value of dissenting shareholders' stock in the merged corporation are deductible as an ordinary and necessary business expense, or are nondeductible capital outlays.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 162 and 263 of the Internal Revenue Code of 1954 and Section 1.263(a)-2 of the Regulations thereunder are set forth in Appendix C, *infra*, pp. 25-26.

STATEMENT

As of September 1953, Hilton Hotels Corporation ("Hilton") owned 325,370.5 of the 366,040.75 issued shares of Hotel Waldorf-Astoria ("Waldorf"). In August 1953, Hilton retained Standard Research Consultants, Inc., to prepare a merger study to determine the number of Hilton shares that would be a fair basis for an exchange for each of the 40,670.25 outstanding Waldorf shares not held by Hilton. The

final report submitted by Standard Research in October 1953 concluded that Hilton would be justified in offering 1.25 shares of its common stock for each share of Waldorf stock as a fair basis of merger. (R. 5-6.)

On November 12, 1953, Hilton and Waldorf entered into an agreement of merger which provided that Hilton would be the surviving corporation and 1.25 shares of Hilton stock would be offered for each outstanding Waldorf share not held by Hilton.[2] Subsequently, on December 28 and 29, 1953, the holders of more than two-thirds of the stock of Hilton and Waldorf voted to approve the merger. Prior to the vote, the holders of 20,221 Waldorf shares, pursuant to Section 91 of the New York Stock Corporation Law, filed with Waldorf their written objections to the merger and demanded payment for their stock. Thereafter, on December 31, 1953, the merger agreement and the certificate of consolidation were filed and recorded with the Secretary of State of New York, pursuant to Section 91 of the New York Stock Corporation Law. (R. 6-7.)

On January 7, 1954, Hilton offered to the dissenting holders of the 20,221 Waldorf shares a payment of $24.54 per share. The offer was rejected and the dissenting shareholders began proceedings, pursuant to Section 21, New York Stock Corporation Law, in the Supreme Court of New York (New York County)

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[2] The Waldorf shares held by both Waldorf (as treasury stock) and Hilton were to be cancelled upon the filing and recording of the merger agreement (R. 6).

for a determination of the value of their Waldorf shares. (R. 7-8.)

During the period January through May, 1954, Hilton asked Standard Research to value the Waldorf common stock as of December 27, 1953, the day prior to the shareholders' vote approving the merger. This valuation study included the preparation of charts and tables supporting its opinion and the giving of testimony in the appraisal proceedings. The amount paid to Standard Research for all of its services (both before and after December 31, 1953) was $17,500. Hilton also obtained the services of lawyers and other professional services in connection with the appraisal proceedings. The fees for these services came to $39,758.62. Ultimately, the appraisal proceedings were terminated by order of the New York County Supreme Court on June 14, 1955, upon its approval of the parties' settlement.[3] (R. 8, 9-11.)

The sole issue litigated in the district court was whether the fee paid to Standard Research and the other fees and costs incident to the appraisal proceeding were nondeductible capital outlays, as the Government contended, or were immediately deductible ordinary and necessary business expenses, as Hilton urged. Hilton conceded and the district court held that so much of the payment to Standard Research as pertained to the determination of a fair basis of

[3] The settlement provided for payment of five-eighths of a share of Hilton stock for each share of Waldorf stock, but without any fractional shares issued. In addition, Hilton was to pay $6 for each one-eighth share of Hilton common stock which would have otherwise been required to be issued as a fractional share. (R. 9-10.)

merger between Waldorf and Hilton could not be currently deducted. This holding was based on the established rule that expenses incurred in connection with a corporate reorganization are nondeductible capital outlays. (R. 36-37.) The district court concluded in favor of respondent, however, that the fees and costs relating to the appraisal proceeding were currently deductible on the ground that the "merger was already effective and the expenses incurred by the corporation in the appraisal proceeding were not reorganization expenses" (R. 39). On appeal, the Seventh Circuit affirmed (Appendix A, *infra*, pp. 18-23).

REASONS FOR GRANTING THE WRIT

The decision below is directly in conflict with that of the Eighth Circuit in *Woodward* v. *Commissioner*, 410 F. 2d 313, affirming 49 T.C. 377, taxpayer's petition for certiorari pending, No. 412, this Term,[4] and is at odds with well-settled case law concerning the tax treatement of expenditures incurred in connection with acquisitions of capital assets and corporate reorganizations. Because of the large number of corporate acquisitions in recent years, the question whether the costs of appraisal proceedings are capital expenditures or currently deductible expenses is a recurring one in the administration of the Internal Revenue Code. This Court should resolve the conflict to eliminate confusion in this area of the tax

[4] The Commissioner intends to acquiesce in the grant of the petition in *Woodward*.

law and to ensure even-handed treatment of similarly situated taxpayers.

1. The federal income tax law has long made the distinction between expenditures which are currently deductible against income and those which must be capitalized. Thus, while Section 162 of the 1954 Code and its predecessor provisions have allowed a current deduction for "ordinary and necessary [business] expenses", Section 263 forbids a current deduction for "capital expenditures." Such expenditures have been defined since the inception of the present income tax in 1913 as "any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."[5] If an expenditure falls within the scope of this statutory definition, it constitutes the cost basis (or a part thereof) of the property (see Section 1012) and, unless the property is subject to depreciation or amortization, its cost is recoverable only when the property is ultimately sold.[6]

Capital expenditures are usually defined as those outlays made to acquire a tangible or intangible asset or benefit with a useful life of more than a year. See

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[5] This language was first used in Section II(B) of the Revenue Act of 1913, c. 16, 38 Stat. 114, 167, and has been included in each successive income tax statute.

[6] This Court has on numerous occasions considered the variant treatment accorded those business expenditures which qualify for an immediate deduction under Section 162 and those which must be capitalized under Section 263. See, *e.g.*, *Commissioner* v. *Tellier*, 383 U.S. 687, 689-690; *Spreckels* v. *Commissioner*, 315 U.S. 626; *Deputy* v. *du Pont*, 308 U.S. 488, 496-497; *Helvering* v. *Winmill*, 305 U.S. 79; *Welch* v. *Helvering*, 290 U.S. 111, 113-116.

Wells-Lee v. *Commissioner*, 360 F. 2d 665 (C.A. 8); *Teitelbaum* v. *Commissioner*, 294 F. 2d 541, 544 (C.A. 7), certiorari denied, 368 U.S. 987; *United States* v. *Akin*, 248 F. 2d 742, 744 (C.A. 10), certiorari denied, 355 U.S. 956. Since the benefit derived from costs incurred in connection with the acquisition of a capital asset, such as legal, accounting, brokerage and other similar expenses, constitute part of the cost of acquiring the asset, such outlays constitute capital expenditures to be added to the cost basis of the asset for purposes of computing gain or loss on disposition. See, *e.g.*, *Helvering* v. *Winmill*, 305 U.S. 79; *Godfrey* v. *Commissioner*, 335 F. 2d 82 (C.A. 6), certiorari denied, 379 U.S. 966; *Spangler* v. *Commissioner*, 323 F. 2d 913 (C.A. 9); *United States* v. *St. Joe Paper Co.*, 284 F. 2d 430 (C.A. 5);[7] *Atzingen-Whitehouse Dairy, Inc.* v. *Commissioner*, 36 T.C. 173. Costs incurred in connection with a corporate reorganization also are subject to capital treatment. As in the case of costs incurred in the acquisition of capital assets, reorganization expenses are capitalized because they provide a benefit extending beyond the year in which they are incurred. See, *e.g.*, *General Bancshares Corp.* v. *Commissioner*, 326 F. 2d 712, 715 (C.A. 8), certiorari denied, 379 U.S. 832; *Missouri-Kansas Pipe Line Co.* v. *Commissioner*,

[7] While the thrust of the prior decision of the Fifth Circuit in *Naylor* v. *Commissioner*, 203 F. 2d 346, is to the contrary, we believe that the subsequent opinion in *St. Joe Paper Co.* represents the law of that Circuit. Moreover, the soundness of *Naylor* has been questioned by the Ninth Circuit in *Spangler* and in 4A Mertens, Law of Federal Income Taxation (Rev.), Sec. 25A.12, n. 40.

148 F. 2d 460, 462 (C.A. 3); *Skenandoa Rayon Corp.* v. *Commissioner*, 122 F. 2d 268, 271 (C.A. 2), certiorari denied, 314 U.S. 696; *Motion Picture Capital Corp.* v. *Commissioner*, 80 F. 2d 872 (C.A. 2); *Odorono Co.* v. *Commissioner*, 26 B.T.A. 1355.[8]

The court of appeals held that these fundamental rules of federal income taxation were inapplicable to the expenses arising out of the appraisal proceeding whereby the price of the dissenting Waldorf shareholders' stock was determined. It did so on the ground that the "primary purpose" (Appendix A, *infra*, p. 23) of the appraisal proceeding was merely to determine the fair value of the dissenters' shares and was not related to their acquisition or to the merger of Waldorf into respondent. As a consequence of this analysis, the court concluded that the appraisal expenses were ordinary and necessary business expenses. Because of its failure to recognize that the rules regarding acquisitions of capital assets and corporate reorganizations were applicable to the expenses incident to the appraisal proceeding, the decision of the Seventh Circuit is unsound and should not be permitted to stand.

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[8] The rule of these cases has been expressly approved by Congress at the time of the 1954 codification. In enacting Section 248 of the 1954 Code, which allows amortization of certain organizational expenses of a corporation, both the House and Senate Committee Reports stated that "[e]xpenditures connected with the reorganization of a corporation are not incident to the creation of a corporation, and hence are not subject to the provisions of section 248." H. Rep. No. 1337, 83d Cong., 2d Sess., p. A64 (3 U.S.C. Cong. & Adm. News (1954) p. 4017, 4201); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 224 (3 U.S.C. Cong. & Adm. News (1954), pp. 4621, 4860-4861).

2. The decision below is squarely in conflict with *Woodward* v. *Commissioner*, 410 F. 2d 313 (C.A. 8th), affirming, 49 T.C. 377, petition for certiorari pending, No. 412, this Term. The taxpayers in *Woodward* were majority stockholders in a corporation whose charter was due to expire in 1961. In 1960, these stockholders voted to renew the corporate existence perpetually with one minority shareholder dissenting. Since taxpayers were obligated to purchase the minority shares voting against renewal at "real value" and no agreement as to real value could be obtained, they commenced a court action in equity, identical in purpose to the appraisal proceeding in this case, to fix the value of the stock. In connection with this litigation, taxpayers paid attorneys', accountants' and appraisers' fees. Contrary to the result and reasoning of the decision below, both the Tax Court and the Eighth Circuit held that these litigation costs were nondeductible capital expenditures incident to the purchase of the dissenter's stock.

The Eighth Circuit's decision rests upon the familiar principle, to which we have referred, p. 7, *supra*, that costs incurred in connection with the acquisition of a capital asset are capital expenditures. So well established is this principle that more than thirty years ago, this Court recognized it in approving longstanding Treasury Regulations[9] to the effect

[9] Treasury Regulations 33 (1918 ed.), Article 8, par. 108; Treasury Regulations 45 (1920 ed.), Article 293; Treasury Regulations 62, Article 293; Treasury Regulations 65, Article 292; Treasury Regulations 69, Article 292, Treasury Regulations 74, Article 282; Treasury Regulations 77, Article 282; Treasury Regulations 86, Article 24-2; Treasury Regulations

that brokerage commissions paid in the purchase of securities are not deductible but must be added to the basis of the securities. *Helvering* v. *Winmill*, *supra*. The expenditures at issue here are in all pertinent respects similar to such costs as brokerage commissions paid in the purchase of securities and therefore should be treated as capital expenditures. *Erdman* v. *Commissioner*, 315 F. 2d 762 (C.A. 7); *Brown* v. *Commissioner*, 215 F. 2d 697 (C.A. 5); *Commissioner* v. *Macy*, 215 F. 2d 875 (C.A. 2); *Garrett* v. *Crenshaw*, 196 F. 2d 185 (C.A. 4); *Davis* v. *Commissioner*, 151 F. 2d 441 (C.A. 8), certiorari denied, 327 U.S. 783; *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C.A. 4), certiorari denied, 322 U.S. 755; *Pennroad Corp.* v. *Commissioner*, 21 T.C. 1087, affirmed, 228 F. 2d 329 (C.A. 3).

Woodward cannot be distinguished on the ground that the appraisal proceeding there occurred before title to the dissenter's stock passed to the taxpayers, while in this case the title transfer and merger were effected in advance of the appraisal proceeding in accordance with the pertinent provisions of New York law.[10] The basis for the *Woodward* holding re-

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94, Article 24-2; Treasury Regulations 101, Article 24-2; Treasury Regulations 103, Section 19.24-2; Treasury Regulations 111, Section 29.24-2; Treasury Regulations 118, Section 39-24(a)-2; Treasury Regulations (1954 Code), Section 1.263(a)-2(e), Appendix C, *infra*, p. 26.

[10] To the extent the Eighth Circuit (410 F. 2d at 320) attempted to distinguish this case, involving a claimed deduction for ordinary and necessary business expenses under Section 162, from *Woodward*, involving a deduction for expenses for the production or collection of income under Sec-

quiring capitalization was not that title was involved, but rather that the appraisal costs were directly related to the acquisition of the dissenter's stock. In this case, no less than in *Woodward*, the appraisal proceeding was "inextricably woven into the fabric of the overall transaction." 410 F. 2d at 320.[11]

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tion 212, we believe the distinction to be without merit. The deduction under Section 212 and its predecessor provision (Section 23(a)(2) of the 1939 Code, as amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 819) is subject to the same restrictions imposed upon business expense deductions, except it removed the requirement that the expense be incurred in connection with a trade or business. *Trust of Bingham* v. *Commissioner*, 325 U.S. 365; *Lykes* v. *United States*, 343 U.S. 118; Treasury Regulations (1954 Code), Section 1.212-1(n); H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75 (1942-2 Cum. Bull. 372, 430); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 88 (1942-2 Cum. Bull. 504, 571). See also *United States* v. *Gilmore*, 372 U.S. 39, 44-47. The provisions of Section 212 do not in any way impair the established rule that expenses incidental to the purchase of a capital asset are capital expenditures, to be reflected in the computation of the capital gain or loss recognized when the asset is sold. To the contrary, as the Ninth Circuit observed in *Spangler* v. *Commissioner*, *supra*, 323 F. 2d at 918 —"Section 23(a)(2), adopted in 1942 [now Section 212 of the 1954 Code] did not create new types of deductible expenditures; it simply made the old deductions applicable to new categories of income-producing activity." Since the foregoing considerations were set forth by the Eighth Circuit earlier in its *Woodward* opinion 410 F. 2d at 317-318) it diminishes the force of its subsequent distinction (410 F. 2d at 320) between Sections 162 and 212.

[11] That the decision below runs contrary to the mainstream of case law in this area was recognized by the Eighth Circuit in *Woodward*. In discussing the relevant authorities, the Eighth Circuit implicitly disapproved (410 F. 2d at 320) the holding in *Smith Hotel Enterprises* v. *Nelson*, 236 F. Supp. 303 (E.D. Wis.), principally relied upon by the decision below,

3. Relying on New York law, the court of appeals determined that the appraisal proceeding did not function primarily to permit the acquisition of the dissenting Waldorf shareholders' stock and was not necessary to the consummation of the merger. Appendix A, *infra*, pp. 21-23. The court therefore concluded that the primary purpose of the appraisal proceeding was simply to value the dissenters' shares, and that the expenses incurred in connection therewith were ordinary and necessary business expenses.

In finding the appraisal proceeding to be a distinct event conceptually separate from the acquisition of the dissenters' shares or the merger, the court of appeals fell into error. That proceeding was not only

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and endorsed as the "better view" the decision of *Boulder Building Corp.* v. *United States*, 125 F. Supp. 512 (W.D. Okla.). Moreover, an examination of the district court's opinion in *Smith Hotel Enterprises* reveals that its principal reliance was upon *Heller* v. *Commissioner*, 147 F. 2d 376 (C.A. 9), certiorari denied, 325 U.S. 868. There, the Ninth Circuit held that the appraisal proceeding expenses incurred by a dissenting shareholder were deductible under Section 212. But the subsequent decision of that court in *Spangler* v. *Commissioner*, 323 F. 2d 913, expressly disapproved its prior *Heller* decision to the extent that it may have been premised on the assumption that the predecessor of Section 212 "created a new category of deductions". See 323 F. 2d, pp. 919-920, n. 15. We therefore believe that the *Spangler* decision represents the governing rule in the Ninth Circuit. In that case, the taxpayer sought to deduct litigation expenses of a suit in which she recovered, *inter alia*, the value of stock on liquidation. The Ninth Circuit held that the litigation expenditure was a capital outlay on the theory that "Costs connected with the disposition of a capital asset are also capital expenditures to be added to taxpayer's basis, or offset against the sales price, rather than expenses deductible from ordinary income." See 323 F. 2d at 921.

directly related to the acquisition or merger, but indeed, had no independent purpose of its own. The fact that the stock acquisition or merger preceded the appraisal proceeding under state law cannot mask their functional relationship for federal tax purposes. See *Spangler* v. *Commissioner*, 323 F. 2d 913, 921 (C.A. 9); *Munson* v. *McGinnes*, 283 F. 2d 333 (C.A. 3), certiorari denied, 364 U.S. 880. See also *Arrowsmith* v. *Commissioner*, 344 U.S. 6.

4. The court below and the Eighth Circuit in *Woodward* disagreed not only as to the ultimate treatment of the appraisal expenses incurred in each case but also as to the proper test to be applied in characterizing the expenses for tax purposes. While the court below held that the "primary purpose" test of its decision in *Rassenfoss* v. *Commissioner*, 158 F. 2d 764 (C.A. 7), was applicable, the Eighth Circuit specifically considered and rejected this test as having no application to litigation expenses that are directly connected to the acquisition of a capital asset. 410 F. 2d at 316. As the Eighth Circuit explained, the "primary purpose" test is relevant only in the case of litigation concerning title to property, where the general rule has been that the cost of defending or perfecting title to property is a nondeductible capital expenditure. Treasury Regulations on Income Tax (1954 Code), Section 1.263(a)-(2)(c), Appendix C, *infra*, p. 26. As an adjunct to this rule, some courts have employed a "primary purpose" test and have allowed a current deduction where title was involved but the defense or perfection of that title was only incidental to the litigation. See, *e.g.*, *Rassenfoss* v.

Commissioner, supra; Manufacturers Hanover Trust Co. v. *United States*, 312 F. 2d 785 (Ct. Cl.), and cases cited therein. See also *Kornhauser* v. *United States*, 276 U.S. 145.

United States v. *Gilmore*, 372 U.S. 39, not cited by the court below, but relied upon by the Eighth Circuit in *Woodward*, 410 F. 2d at 319, prescribes the test to be applied in determining the treatment of the appraisal expenses incurred by Hilton. In *Gilmore*, this Court held that this determination is to be made by reference to "the origin and character of the claim with respect to which an expense was incurred." 372 U.S. at 49. Although *Gilmore* involved the question whether certain expenses were business or personal expenses, its rationale applies with equal force in this case. Since the origin of the claim with respect to which the appraisal expenses were incurred was the stock acquisition or merger, and since the character of the claim indisputably was capital in nature—the amount to be paid for a capital asset or in connection with a corporate reorganization—the appraisal expenses must be considered a part of the cost of acquiring the shares and thus a nondeductible capital expenditure.

5. The court of appeals thought that its "conclusion in this case obviously is a narrow one related specifically to a factual situation controlled by New York statutes." Appendix A, *infra*, p. 23. Quite the contrary is true, however. Our research has disclosed that in addition to New York, 48 other states and the District of Columbia [12] accord dissenting share-

[12] The lone exception is West Virgina.

holders an appraisal remedy,[13] and that in all of these jurisdictions the general rule is that a duly approved

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[13] Code of Ala., tit. 10, §§ 21(66), 21(73); Alaska Comp. Stat. Ann., §§ 36-2A-93, 36-2A-95, 36-2A-97; Ariz. Rev. Stat. Ann., §§ 10-345, 10-346, 10-347; Ark. Stat. Ann. §§ 64-703—64-705, 64-707; Calif. Corp. Code, §§ 4113, 4123, 4300; Colo. Rev. Stat. Ann., §§ 31-7-3, 31-7-4, 31-7-5, 31-7-8; Conn. Gen. Stat. Ann., §§ 33-366, 33-367, 33-368, 33-374; Del. Code. Ann., tit. 8, §§ 251, 262; D.C. Code, § 29-240; Fla. Stat. Ann., §§ 608.-20, 608.23; Code of Ga. Ann., §§ 22-1838, 22-1845—22-1847; Hawaii Rev. Stat., §§ 417-3, 417-4, 417-8, 417-19—417-26; Idaho Code, §§ 30-152, 30-154, 30-156; Smith-Hurd III. Ann. Stat., ch. 32, §§ 157.63—157.70; Burns Ind. Ann. Stat. §§ 25-231—25-236; Iowa Code Ann., §§ 491.104—491.108, 491.112; Kan. Stat. Ann., §§ 17-3701—17-3707; Ky. Rev. Stat., §§ 271.470, 271.480, 271.490; La. Rev. Stat. Anno., Rev. Stat. §§ 12.112, 12.114, 12.131; Me. Rev. Stat. Ann., tit. 13, §§ 242-244, 281-291; Ann. Code of Md., Art. 23, §§ 66, 73; Mass. Ann. Laws, ch. 156, §§ 46A, 46B, 46E; Mich. Stat. Ann., §§ 21.52-21.54; Minn. Stat. Ann., §§ 301.42, 301.44; Miss. Code Ann., §§ 5309-151, 5309-153, 5309-156, 5309-172; Vernon's Ann. Mo. Stat., §§ 351.420, 351.425, 351.440, 351.455; Rev. Codes of Mont. Ann., §§ 15-2267, 15-2269, 15-2273, 15-2274; Rev. Stat. of Neb., §§ 21-1,104, 21-1,109; Nev. Rev. Stat., §§ 78.450, 78.505; N.H. Rev. Stat. Ann., §§ 294:42, 294:77—294:80; N. J. Stat. Ann., §§ 14A:10-3, 14A:10-4, 14A:11-1—14A:11-9; N.M. Stat. Ann., §§ 51-27-1—51-27-3, 51-27-6, 51-28-3—51-28-4; Gen. Stat. of N.C., §§ 55-108—55-110, 55-113; N.D Cent. Code Ann., §§10-20-03, 10-20-04, 10-20-06, 10-20-08; Page's Ohio Rev. Code Ann., §§ 1701.79, 1701.80, 1701.85; Okla. Stat. Ann., tit. 18, §§ 1.157—1.161, 1.166; Ore. Rev. Stat., §§ 57.432—57.475; Purdon's Pa. Stat. Ann., tit. 15, §§ 801—805, 1515. 1905—1908; Gen. Laws of R.I., §§ 7-5-3, 7-5-7, 7-5-8—7-5-15; Laws of S.C., §§ 12-16.27, 12-20.1—12-20.9; S.D. Code, §§ 11.02A01—11.02A07; Tenn. Code Ann., §§ 48-901—48-905, 48-909—48-918; Business Corp. Act, Vernon's Tex. Civ. Stat., Arts. 5.07, 5.11, 5.12; Utah Code Ann., §§ 16-10-68, 16-10-69, 16-10-75, 16-10-76; Vt. Stat. Ann., tit. 11, §§ 38-161, 38-162, 38-381, 38-382; Va. Code Ann., §§ 13.1-70—13.1-75; Rev. Code of Wash. Ann., §§ 23A.20.010—23A.20.060, 23A.24.030—23A.24.040; West's Wis. Stat. Ann., §§ 180.64—180.69; Wyo. Stat. Ann., §§ 17-36.63—17-36.72.

merger or consolidation becomes effective upon the filing or recordation of an appropriate certificate with state authorities even though some shareholders may have dissented. The federal law relating to the merger or consolidation of national banking institutions, which also provides an appraisal remedy, likewise permits a merger to be effected before dissenting shareholders have been compensated for their stock. 12 U.S.C. 214a(b).

Given the widespread availability of appraisal remedies under both state and federal law and the relatively large numbers of corporate mergers and acquisitions in recent years, the question in this case is one which will constantly recur.[14] Furthermore, it is a question that particularly affects the planning of corporate acquisitions where the attendant expenses incident to an appraisal proceeding can be quite substantial. It is essential, therefore, that both the tax bar and the Treasury have a settled rule as to whether such expenditures are capital in nature or whether

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[14] We have been advised by the Internal Revenue Service that apart from *Woodward* and the instant case, there is one other case pending in the courts involving the deductibility of fees incurred in connection with appraisal proceedings. The total amount of revenue involved in these three cases is approximately $53,000. In addition, there are 60 cases pending administratively involving $2,598,977 of revenue, which includes $56,510 arising out of a similar merger transaction involving respondent for subsequent years. This figure also includes $32,500 of revenue in a case involving the petitioners in *Woodward* for subsequent years. Moreover, there are at least 11 cases pending in the courts concerning the deductibility of fees paid in connection with the acquisition or sale of stock, which involve approximately $250,000 of deductions. With respect to this issue, there are 75 cases pending administratively involving $5,887,854 of revenue.

they may be deducted currently. This objective can be achieved only through a resolution by this Court of the conflict of decisions between the Seventh and Eighth Circuits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

JOHNNIE M. WALTERS,
Assistant Attorney General.

MATTHEW J. ZINN,
Assistant to the Solicitor General.

GILBERT E. ANDREWS,
STUART A. SMITH,
Attorneys.

AUGUST 1969.

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1968—JANUARY SESSION, 1969

No. 17124

HILTON HOTELS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

April 15, 1969

Before HASTINGS, Senior Circuit Judge, and KILEY and KERNER, *Circuit Judges.*

HASTINGS, *Senior Circuit Judge.* The United States appeals from a district court decision in a refund suit brought by taxpayer Hilton Hotels Corporation (Hilton). The sole issue raised by this appeal [1] is whether the district court erred, as the Government contends, in holding that expenditures incurred by Hilton in connection with an appraisal proceeding to value the stock of dissenting shareholders in a merged corporation are currently deductible ordinary and necessary business expenses. The Gov-

[1] One of the two issues originally presented in this case was settled by the parties.

ernment urges that such expenditures are nondeductible capital outlays.

The relevant facts were stipulated by the parties and adopted by the lower court. They may be summarized in the following manner.

On September 2, 1953, Hilton owned 325,370.5 of the 366,040.75 issued shares of the Hotel Waldorf-Astoria Corporation (Waldorf); the remaining 40,670.25 shares of Waldorf were owned by shareholders other than Hilton or Waldorf.

Contemplating a merger, Hilton retained Standard Research Consultants, Inc. (Standard) to prepare a merger study to determine a fair basis of exchange of Hilton stock for the remaining 40,670.25 shares of Waldorf. Standard concluded that a fair exchange ratio would be 1.25 shares of Hilton common stock for each remaining share of Waldorf stock.

On November 12, 1953, Hilton and Waldorf entered into an agreement of merger which provided that Hilton would be the surviving corporation and that 1.25 of Hilton's shares would be offered for each of the remaining 40,670.25 shares of Waldorf.

The holders of over two-thirds of the stock of Hilton and Waldorf voted in favor of the merger on December 28 and 29, 1953. Prior to this vote of approval, however, the holders of 20,221 shares of Waldorf filed with Waldorf, pursuant to § 91 of the New York Stock Corporation Law,[2] their written objec-

[2] Section 91 reads in relevant part:

"7. Any stockholder * * * included in such consolidation, not voting in favor thereof, may object * * * and demand payment for his stock, at any time prior to the vote * * * The objecting stockholder or the corporation shall have the right to have such stock appraised and paid for in the manner provided, and subject to the conditions imposed by section twenty-one. * * *."

tions to the proposed merger and demanded payment for their stock.

On December 31, 1953, the merger agreement and the certificate of consolidation were filed and recorded with the Secretary of State of New York in accordance with the relevant provisions of § 91. Thereafter and pursuant to § 21, Subdivision 1, of the New York Stock Corporation Law [3], Hilton offered to the objecting holders of the Waldorf stock a payment of $24.54 for each share of the remaining 20,221 shares. The Hilton offer was rejected, and on February 11, 1954, pursuant to § 21 [4], the dissenting holders commenced appraisal proceedings in the Supreme Court for the County of New York to determine the value of their shares of Waldorf. These proceedings continued until June 14, 1955, when the New York court approved the parties' settlement of

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[3] Section 21 reads in relevant part:

"1. In the event that the stockholders of a corporation have taken action pursuant to [section] * * * ninety-one * * * and if any stockholder has objected to such action and demanded payment for his stock as provided in * * * section ninety-one * * * the corporation, * * *, shall mail * * * to such objecting stockholder * * * a written offer to pay for such stock in cash at a price deemed by the corporation to be the value thereof; * * *."

[4] Section 21 reads in relevant part:

"3. If the corporation shall fail to make an offer within the time specified in subdivision one hereof, or if the objecting stockholder shall fail to accept an offer from the corporation within twenty days after the mailing * * *, either such stockholder or the corporation may petition the supreme court, at any special term thereof held within the judicial district in which the principal office of the corporation is situated, to determine the value of such stock."

the valuation dispute and ordered the appraisal proceedings terminated.

This suit presents the problem of characterizing for the purpose of taxation the nature of the expenses incurred by Hilton in connection with the appraisal proceeding.

It is axiomatic that if the Hilton expenditures are deemed to have been incurred, as the Government urges, in corporate reorganization or recapitalization they are not deductible. *General Bancshares Corp.* v. *C.I.R.*, 8 Cir., 326 F. 2d 712, 715, *cert. denied*, 379 U.S. 832 (1964) and cases cited therein. It is equally true, however, that if such expenditures are held to be ordinary and necessary business expenses they are deductible. Int. Rev. Code of 1954, § 162.

The line of demarcation between the deductible and the nondeductible expenditure is frequently difficult to perceive because the "* * * decisive distinctions [between the two] are those of degree and not of kind." *Welch* v. *Helvering*, 290 U.S. 111, 114 (1933). The applicable rule generally held to govern in such situations is the *primary purpose* test. *Rassenfoss* v. *Commissioner of Internal Revenue*, 7 Cir., 158 F. 2d 764, 767 (1946); *Manufacturers Hanover Trust Co.* v. *United States*, U. S. Ct. Cl., 312 F. 2d 785, 789, *cert. denied*, 375 U.S. 880 (1963).

In the instant case, we are satisfied the district court appropriately considered and applied the primary purpose doctrine and affirm its decision which held that the Hilton expenditures, arising out of the appraisal proceedings, were deductible as ordinary and necessary business expenses. *Hilton Hotels* v. *United States*, D.C. N.D. Ill., 285 F. Supp. 617 (1968).

In reaching its decision, the district court found that the Hilton-Waldorf merger became effective un-

der New York law upon filing the Certificate of Consolidation with the Secretary of State.[5] It further found under New York law that the objecting Waldorf holders had no interest other than to receive payment of the fair value of their stock[6] and that the *sole purpose* of the appraisal proceedings was to determine the fair value of the objecting holders' shares in Waldorf. As a result of such findings, the court concluded that the expenses experienced by Hilton in connection with such proceedings were not capital in nature and were therefore deductible as ordinary and necessary business expenses. We agree.

Like the district court, we feel that the rationale of *Smith Hotel Enterprises, Inc.* v. *Nelson*, D.C.E.D. Wisc., 236 F. Supp. 303 (1964) is germane to the instant case. In *Smith*, the corporate taxpayer received an offer to purchase substantially all its assets. One shareholder objected to the offer and pursuant to the controlling state statute demanded from the

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[5] Section 91 of the New York Stock Corporation Law reads in material part:

> "9. The consolidation authorized by the provisions of this section shall become effective for all purposes of the laws of this state upon filing in the office of the secretary of state the certificate [of consolidation] * * *."

[6] Section 21 of the New York Stock Corporation Law provides:

> "6. Any stockholder demanding payment for his stock shall have no right to receive any dividends or distribution payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights of a stockholder of the corporation in respect to such stock, *except the right to receive payment for the value thereof* * * *." [Emphasis supplied.]

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236 F. Supp. *supra* at 305-30

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Appeals for th

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APPENDIX B

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

No. 17124

Tuesday, April 15, 1969

HILTON HOTELS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

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Before HON. JOHN S. HASTINGS, *Senior Circuit Judge*, HON. ROGER J. KILEY, *Circuit Judge*, HON. OTTO KERNER, *Circuit Judge*.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this day.

APPENDIX C

Internal Revenue Code of 1954:

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

* * * *

[26 U.S.C. 162.]

SEC. 263. CAPITAL EXPENDITURES.

(a) *General Rule.*—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or depostis deductible under section 616,

(B) research and experimental expenditures deductible under section 174, or

(C) soil and water conservation expenditures deductible under section 175.

* * * *

[26 U.S.C. 263.]

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.263(a)-2 *Examples of capital expenditures.*

The following paragraphs of this section include examples of capital expenditures:

* * * *

(c) The cost of defending or perfecting title to property. * * * *

(e) Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense.

* * * *

(26 C.F.R. 1.263(a)-2.)

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IN THE

Supreme Court of the United States

OCTOBER TERM 1969.

No. 528

UNITED STATES OF AMERICA,
Petitioner,

vs.

HILTON HOTELS CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

RESPONDENT'S BRIEF IN OPPOSITION.

MILTON A. LEVENFELD,
BURTON W. KANTER,
RICHARD M. KATES,
10 South LaSalle Street,
Chicago, Illinois 60603,
Attorneys for Respondent.

THE BLAKELY PRINTING COMPANY, CHICAGO

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IN THE

Supreme Court of the United States

OCTOBER TERM 1969.

No. 528

UNITED STATES OF AMERICA,
Petitioner,

vs.

HILTON HOTELS CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

RESPONDENT'S BRIEF IN OPPOSITION.

STATEMENT.

The statement of the facts of this case by the Petitioner omits Sections 21(6) and 21(7) of the New York Stock Corporation law, which sections are the basis of the classification of the expenditures in this case. Section 21(6) provides:

> Any stockholder demanding payment for his stock shall have no right to receive any dividends or distributions payable to holders of such stock of record after the close of business on the day next preceding the

> date of the stockholders's vote in favor of the action to which such objection was made, *and upon such vote shall cease to share any other rights of a stockholder of the corporation in respect to such stock except the right to receive payment for the value thereof.* . . . (Emphasis added.)

Section 21(7) provides:

> . . . if payment for the stock of an objecting stockholder shall have been demanded in consequence of action taken on a merger or consolidation pursuant to section eighty-five, eighty-six, or ninety-one, *the shares or other securities of the resulting or surviving corporation into which the shares of the objecting stockholder would have been converted had no objection been made shall . . . be deemed to have been duly issued in accordance with the terms of such certificate and reacquired by the resulting or surviving corporation, and may be held or disposed of by it free of any preemptive rights of stockholders.* (Emphasis added.)

Under Section 21(3) of the New York Stock Corporation Act, if a stockholder who lost his proprietary rights to stock under the above provisions was not satisfied with the monetary value the corporation placed on the stock, that stockholder could institute a proceeding for an appraisal and an accounting of the stock's value. It is the treatment of the cost of that type of proceeding which was the sole issue decided by the Appellate Court under the peculiar provisions of New York law.

ARGUMENT.

I.

THE APPELLATE COURT CORRECTLY APPLIED ESTABLISHED PRINCIPLES OF FEDERAL LAW. THIS CASE WAS RIGHTFULLY DECIDED ON THE BASIS OF A SPECIFIC FACT SITUATION.

The Petitioner asserts in its first argument that the Appellate Court erroneously did not apply an allegedly clear legal principle when it held that the expenditures of Hilton in the appraisal proceeding involving the valuation of stock in which the stockholders had lost their proprietary rights were ordinary and necessary business expenses.

The first argument of Petitioner is based on the erroneous and overly simplistic statement that all expenditures incurred in connection with the acquisition of capital assets or with a corporate reorganization are capital expenditures. This argument neglects the fact that the District Court[1] found and the Appellate Court[2] concurred that the appraisal proceedings occurred after and were separate from both the merger and the acquisition of the stockholder's proprietary rights. Further, Petitioner's generalization regarding classification of expenditures neglects the necessary appreciation of particular fact situations, for as Justice Cardoza stated:

> to attempt to harmonize them (cases determining the nature of expenses) would be a futile task. They involve the appreciation of particular situations, at times with border-line considerations.[3]

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1. *Hilton Hotels* v. *United States*, 285 F. Supp. 617 (N. D. Ill. 1968)
2. *Hilton Hotels* v. *United States*, 410 F. 2d 194 (7th Cir. 1969)
3. *Welch* v. *Helvering*, 290 U. S. 111 at 116 (1933)

As is illustrated by the cases below, the fact that one can demonstrate that there is some relationship between an expense and a capital transaction does not cause that expense to be classified as a capital expense. Courts have consistently stated that while legal expenditures related primarily to question of title to property are capital expenditures, the line of demarcation between an ordinary and necessary expense and an expenditure incurred primarily regarding title to property is extremely narrow and where the issue of title is secondary the whole expense may be deductible. The mere fact that stock ownership may somehow be affected does not mean that legal expenditures primarily involve questions of title and are automatically classified as capital expenditures, for if such were the rule of law every expenditure relative to income producing property would be a capital expenditure thereby emasculating all deductions related to income producing property.[4]

In *Usry* v. *Price*[5] the state of Louisiana had twice challenged the taxpayer's right to title and income from oil wells. The Commissioner of Internal Revenue took the position that since in the second case legal fees were incurred for the protection of title they were capital expenses. The court said that in every case where income is derived from property one may find lurking somewhere in the background a question of title. The court said that it was not its province to adjudicate the issue of title but rather it was to decide whether that issue had been adjudicated and settled and if so at what time. The court said that since the issue of title had been adjudicated in the first Louisiana

4. See *Sergievsky* v. *McNamara*, 135 F. Supp. 233, (S. D. N. Y. 1955), which involved a suit to impose a constructive trust on stock as well as to obtain an accounting for the value of other stock which had already been transferred by the defendant. Similarly, *Guttmann* v. *United States*, W. D. Pa. Civil Nos. 17037 and 17318, 60-1 USTC 9310 (1960).

5. 325 F. 2d 657 (5th Cir. 1963)

case and was *res judicata,* that issue was secondary and did not cause attorney's fees in the second case to be classified as capital expense. In *Naylor* v. *Commissioner*[6] services of an attorney were necessary to collect the proceeds of the sale of a capital asset. The taxpayer's attorney was employed *after* an enforceable contract of sale existed. His fees were held to be deductible rather than a capital expenditure.

In *Rassenfoss* v. *Commissioner*[7] the taxpayer was sued for the adjudication of a third party's claim in his partnership property and for an accounting. The court held that it was perfectly plain that the main purpose of the suit was an accounting for value and that any questions of title were merely incidental and did not control the characterization of legal fees which were deemed to be noncapital expenditures.

The following situations are but a few of those wherein legal fees were incurred and were declared to be noncapital expenditures: the acquisition of stock to better control the corporate management;[8] the regaining of title to stolen property;[9] the interference by an investment company in a reorganization proceeding involving another corporation to protect its own stock investment in that corporation;[10] the acquisition of stock to prevent a stockholder from further disrupting corporate operations;[11] the working out of a purchase procedure and valuation formula for the pur-

6. 203 F. 2d 346 (5th Cir. 1953)

7. 158 F. 2d 764, (7th Cir. 1946), Note also *Marsh* v. *Squire,* U. S. D. C. W. D. Wash. No. 993, 48-1 USTC 9142 (1947)

8. *Straub* v. *Granger,* D. C. W. D. Pa. Civil Action No. 9429-9431, 56-1 USTC 9551 (1956)

9. *Vincent* v. *Commissioner,* 219 F. 2d 228 (9th Cir. 1955)

10. *Allegheny Corporation,* 28 TC 298 (1957)

11. *General Pencil Company,* TC Memo Opinion Docket No. 3616 (June 17, 1944) (3 TCM 603, CCH Dec. 14, 002 [M]

chase of a majority stockholder's holdings under a buy-sell agreement;[12] and the stock valuation proceedings held under state law due to a merger.[13]

In the above cases capital transactions such as acquisitions of capital assets or mergers were considered incidental to the purpose for which the legal expenditures were incurred, or were deemed to be separated from such expenditures, or their capital nature was overshadowed by still other considerations. These cases illustrate the fallacy of the government's position based on the generalization that connection of an expenditure with a capital transaction causes the expenditure to be a capital expenditure. This clearly is not true.[14] Particular situations not generalizations govern the classification of expenditures. The Appellate Court rightfully based its decision on particular facts.

II.

THERE IS NO CONFLICT BETWEEN THE CIRCUITS AS TO THE NATURE OF THE EXPENSES INCURRED BECAUSE THE TRANSACTIONS INVOLVED DIFFER SUBSTANTIALLY.

Petitioner claims that there is a conflict between the circuits because two circuits differently classified expenses which arose out of appraisal proceedings to determine the value of stock held by dissenting stockholders. Petitioner neglects to show that the fact situation surrounding the appraisal proceedings as well as the statutes governing each proceeding differed greatly.

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12. *Gravois Planing Mill Co.* v. *Commissioner,* 299 F. 2d 199 (8th Cir. 1962)

13. *Smith Hotel Enterprises, Inc.* v. *Nelson,* 236 F. Supp. 303, (E. D. Wisc. 1964) *Heller* v. *Commissioner,* 147 F. 2d 376 (9th Cir. 1945) ; Cert. denied 325 U. S. 868 (1945) where the Supreme Court did not grant Certiorari in a case which was extremely similar to the instant case.

14. *Welch* v. *Helvering, supra* at Footnote 3

In *Woodward*[15] the single Iowa statute[16] that governed the appraisal proceeding dealt with dissenting stockholder's rights arising solely because of the *renewal of the corporate charter*. In *Hilton* the appraisal proceeding arose and is governed by New York statutes[17] dealing with the rights of a dissenting stockholder in a corporate *merger*. In *Woodward* assenting stockholders were required by the statute to purchase the stock of the dissenting stockholders, thus *increasing* the shares they held in the corporation. In *Hilton* it was the *corporation* which was required by statute to acquire the stock of the dissenting stockholders.[18] In *Woodward* the Iowa statute did not state that dissenting stockholders lose any of their rights as stockholders prior to the *actual* sale of their stock to assenting stockholders and such sale was not required to take place until *three years after* the vote for renewal of the charter. In *Hilton* under New York law the dissenting stockholders *upon the vote affirming the merger* ceased to have any rights of stockholders and had only the right to receive value[19] which was to be determined as of the date preceding that vote.[20] The corporation was then deemed to own their stock.[21] The appraisal proceeding in *Woodward* took place under Iowa statute *just prior to the sale* of the dissenting stockholders interest whereas in *Hilton* under New York law the dissent-

15. *Woodward* v. *Commissioner*, 410 F. 2d 313 (8th Cir. 1969)

16. Iowa Code § 491.25 (1966)

17. New York Stock Corporation Act § 21, 91

18. New York Stock Corporation Act § 21(1), 21(3), 91(7)

19. New York Stock Corporation Act § 21(6)

20. New York Stock Corporation Act § 21(4)

21. Rev. Ruling 68-285 IRB 1968-23, 17 states that on the date dissenting stockholders lost all rights of stock ownership and only had the right to value for their stock from the corporation, the corporation was deemed to own their stock; also New York Stock Corporation Act § 21(6), 21(7)

ing stockholders lost their rights as stockholders long before the appraisal proceeding.[22]

A further distinction is that the taxpayers in *Woodward* deducted the appraisal expenses under Section 212 of the Internal Revenue Code of 1954, whereas the taxpayers in *Hilton* deducted their expenses under Section 162 thereof. The 8th Circuit in the *Woodward* case specifically distinguished the 7th Circuit *Hilton* decision because *Hilton* was decided under Section 162, and further distinguished the cases by stating:

> The statute involved in Hilton specifically provides that upon objection to merger by a stockholder his shares were deemed to have been required (acquired) by the corporation. As we have seen, there is no such provision in the Iowa statutes regarding corporate renewal.

Because the facts in *Woodward* differ so completely from those in *Hilton* there is no conflict between the circuits.[23]

III.

PROVISIONS OF NEW YORK LAW BY THEIR TERMS HAD VESTED OWNERSHIP OF DISSENTING STOCKHOLDER'S STOCK IN HILTON PRIOR TO THE APPRAISAL PROCEEDING THUS THE APPRAISAL PROCEEDING WAS SEPARATE FROM THE ALREADY ACCOMPLISHED ACT OF ACQUISTION.

Petitioners maintain that the appraisal proceeding for an accounting for the value of the acquired stock after Hilton and the dissenting stockholders did not agree on its value cannot be a separate act for tax purposes from the *earlier*

22. New York Stock Corporation Act § 21(1), 21(3), 21(4), 21(6), 21(7), 91(7)

23. The brokerage fee cases cited by Petitioner are not relevant because expenses incurred for the valuation of acquired stock differ substantially from brokerage fees arising as *part* of a transaction of acquiring or selling stock.

accomplished acquisition of said stock. Saying that a legal proceeding is incidental to, grows out of, or can be foreseen as a result of another transaction begs the question as to the proper classification of the expense incurred.[24] If Petitioner's assertion was correct, expenses for the printing of new stationery, or the changing of current advertising, or because of the increase in franchise tax all due to the merger having taken place would be capital expenses and it is patently clear that they are not.[25]

Petitioner cites *Spangler*[26] and *Munson*[27] to support his contention that the appraisal proceeding and the acquisition are one transaction. In these two cases, legal expenses were incurred in defending suits to rescind or modify the terms of the original sale because said sale was fraudulently induced. The fraud reopened the terms of the original sale and made the reversion of title to the seller a strong possibility. Acquisition and defense of title were the primary issues in those cases.

In *Hilton* the terms of the sale (including the method of stock valuation by court proceedings, if necessary) were established by statute and further ownership of the stock was not in question. Fees incurred in a controversy over the amount due under an enforceable sale of stock are deductible rather than capitalized because the dispute is over valuation of the stock rather than over title to stock or over the duty to deliver the stock.[28]

Petitioner also cited *Arrowsmith,*[29] but that case dealt

24. Respondent's Argument I makes it clear that particular situations govern classifications rather than the finding of some connection to a capital transaction.

25. *Hilton Hotels* v. *Commissioner,* 285 F. Supp. 617 at 618-619 (N. D. Ill. 1969)

26. *Spangler* v. *Commissioner,* 323 F. 2d 913 (9th Cir. 1963)

27. *Munson* v. *McGinnes* 283 F. 2d 333 (3rd Cir. 1960)

28. *Naylor* v. *Commissioner,* 203 F. 2d 346 (5th Cir. 1953)

29. *Arrowsmith* v. *Commissioner,* 344 U. S. 6 (1952)

with whether subsequent accounting and reporting periods affected the classification of expenses and therefore is not germane to the instant case.

It is clear that attorney fees and other appraisal expenses in *Hilton* were not for services relating to the merger or stock acquisition, both of which had already been accomplished under statute[30] but rather were incurred in an appraisal proceeding accounting for the proper amount of money due.[31]

IV.

AN OBSERVATION IN THE OPINION OF ONE CIRCUIT COURT DOES NOT CREATE A CONFLICT BETWEEN CIRCUITS FOR RESOLUTION BY THE UNITED STATES SUPREME COURT AND FURTHER THAT OBSERVATION CAUSED NO CONFLICT BETWEEN THE CIRCUITS.

Petitioner attempts to show a conflict between circuits based on the observation in the Eighth Circuit in *Woodward* that because the acquisition of property is involved it "thus had no need to apply the primary purpose test." Petitioner argues (erroneously) that the origin of the appraisal expenses in *Hilton* was a stock acquisition, and says that because there was a mention of the primary purpose test in *Hilton* by the Seventh Circuit, a conflict is

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30. New York Stock Corporation Act § 21(1), 21(3), 21(4), 21(6), 21(7), 21(9) & 91(7) Also note Rev. Ruling 68-285 IRB 1968-23, 17 stating under circumstances where dissenting stockholders only retain the right to have the corporation pay for the stock, the corporation was deemed to own their stock.

31. *Naylor* v. *Commissioner*, 203 F. 2d 346 (5th Cir. 1953); *Rassenfoss* v. *Commissioner*, 158 F. 2d 764, (7th Cir. 1946); *Marsh* v. *Squire*, USCD W. D. Wash. No. 993, 48-1 USTC 9142 (1947); *Sergievsky* v. *McNamara*, 135 F. Supp. 233, (S. D. N. Y. 1955); *Smith Hotel Enterprises, Inc.* v. *Nelson*, 236 F. Supp. 303, (E. D. Wisc. 1964)

created with the observation of the Eighth Circuit which must be resolved by the United States Supreme Court.[32]

This observation by the Eighth Circuit in *Woodward* was not the basis of its decision. Its decision was based on the fact that an appraisal proceeding was an integral part of a stock purchase. Respondent's Argument III and other prior arguments show that the appraisal in *Hilton* is separate from the earlier acquisition of the stock which was accomplished by operation of law. The Eighth Circuit's observation that the primary purpose test is not applied to the acquisition of property does not create a conflict with *Hilton* where the property was deemed by statute to be acquired prior to incurring the appraisal expenses.

Though the Seventh Circuit Court of Appeals mentions the primary purpose test in *Hilton,* it in fact rendered its decision based on the *sole purpose* of the appraisal proceeding which was to determine the fair value of those Waldorf shares which Hilton had acquired. Certainly no court can ignore the sole purpose of a transaction.

V.

THE SEVENTH CIRCUIT COURT OF APPEALS DECISION IN THE HILTON CASE WAS DECIDED UNDER PECULIAR PROVISIONS OF NEW YORK LAW AND IS NOT A DECISION FOR GENERAL APPLICATION.

Petitioner claims that the Seventh Circuit Court of Appeals erred in its conclusion that the *Hilton* decision was a narrow one applied specifically to a factual situation controlled by New York statutes. Petitioner has based this claim on the fact that forty-eight states and the District of Columbia accord dissenting shareholders an appraisal

32. Respondent does not believe that Certiorari is granted to resolve observations.

remedy. This fact relied on by the Petitioner for the wide applicability of the *Hilton* decision is again based on an erroneous and overly simplistic approach because indicating that states grant appraisal remedies is meaningless without determining what such remedies are and what effect they have on dissenting stockholder's rights.

Under New York statutes the stockholder must both object and demand payment for his stock before the date for the stockholders to vote on the merger.[33] On the date the merger is approved the objecting stockholder ceases to have any rights of a stockholder and only has the right to receive payment for the value of the stock he had held.[34] On that date the corporation is deemed to own the dissenting stockholder's stock.[35] The merger becomes effective at a time after the dissenting stockholder has lost the rights in his stock.[36] After the vote, the corporation should offer the dissenting stockholder compensation for his lost stock rights that the corporation obtained.[37] If this offer is not forthcoming, or is unsatisfactory, the dissenting stockholder may commence a valuation proceeding to determine the true value of the stock as of the day before the affirmative vote for merger when his rights were lost.[38] No other state's statutes cause a dissenting stockholder *prior* to the date the merger is effected to lose all his proprietary stock rights and be granted only the right to receive the value of the stock.[39] This is ignored by Petitioner when it is

33. New York Stock Corporation Act § 91(7)

34. New York Stock Corporation Act § 21(6)

35. *Supra* Footnote 21

36. New York Stock Corporation Act § 21(6), 21(9)

37. New York Stock Corporation Act § 21(1), 21(3)

38. New York Stock Corporation Act § 21(3)

39. With reference to the statutes cited by Petitioner on page 15 of this brief. a. Shareholder loses all proprietary rights only on receipt of agreed payment for his stock in the following states: Ala., Alaska, Ariz., Ark., Cal., Colo., D. C., Ga., Hawaii, Idaho,

one important fact upon which the Seventh Circuit Court of Appeals rendered its decision in the *Hilton* case. The loss of rights and the merger occurred long before the valuation proceeding.

Petitioner also states that the *Hilton* decision is of general applicability because "it is a general rule that a duly approved merger or consolidation becomes effective upon the filing or recordation of an appropriate certificate though some shareholders may have dissented." To say that a merger can occur despite opposition is meaningless to the instant case. It in no way aids in the classification of an expense.

A corporation is a creature of local and state law which determines its stockholder's rights, obligations, and relationships.[40] New York law cannot be ignored and the fact that suits may be pending under the laws of other states is irrelevant. Furthermore, appraisal expense considerations are not key factors in mergers as Petitioner contends because the amount of expense involved and the tax treatment thereof are not of major importance when compared to much larger expenditures for the corporation's purchase of dissenting stockholder's stock and more important tax considerations involved in the general area of tax free mergers.

This case was rightfully decided under the proper appli-

Ill., Iowa, Me., Mass., Minn., Mo., Mont., Neb., N. H., N. C., N. D., Okla., Pa., R. I., S. C., Texas, Wisc. *b.* Shareholder loses general proprietary rights in stock after merger and only after a demand is filed with the corporation in the following states: Conn., Del., Fla., Kan., La., Md., Mich., Miss., N. M., Nev., Ohio, Ore., S. D., Tenn., Utah, Va., Wash., Wyo. *c.* General proprietary rights are lost on merger date: Ind., *d.* General proprietary rights are lost on institution action for value on stock by shareholder: Ky., *e.* Hybrid (rights lost after merger): N. J., Vt.

40. *Hopkins Savings and Loan Association* v. *Cleary*, 296 U. S. 315 (1935), *Aquilino* v. *United States*, 363 U. S. 509 (1960).

cation of federal tax laws to distinctive legal and property rights resulting from the application of provisions of New York law and New York law is not of general application to corporate reorganizations in other states.

CONCLUSION.

For the reasons set forth above indicating that Petitioner has stated no valid reasons for Certiorari, the Petition for Certiorari should be denied.

Respectfully submitted,

MILTON A. LEVENFELD,
BURTON W. KANTER,
RICHARD M. KATES,
10 South LaSalle Street,
Chicago, Illinois 60603,
Attorneys for Respondent.

No. 528

Joiner in petition for
Certiorari filed on
Nov. 13, 1969.
(Not printed)

NO. 528

Vide No. 412 for Brief
for Commissioner + U.S.
(filed Jan. 14, 1970

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969.

No. 528

UNITED STATES OF AMERICA,
Petitioner,

vs.

HILTON HOTELS CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR HILTON HOTELS CORPORATION.

ARGUMENT.

INTRODUCTION AND SUMMARY.

Hilton Hotels Corporation ("Hilton") and the Hotel Waldorf-Astoria Corporation ("Waldorf") entered into a merger agreement. Under the New York law governing the merger, stockholders of Waldorf voting against the merger could demand payment for their Waldorf stock. Certain dissenting Waldorf stockholders demanded payment and by so doing under the terms of New York law they lost their status and rights as stockholders of Wal-

dorf, and they became creditors of Waldorf for the fair value of their stock. As a result of the merger Hilton assumed Waldorf's debts. Hilton and the dissenters could not agree on the amount of the debt to the dissenters. An appraiser was appointed by a court to determine the fair value of the stock, and thus determine the amount of the debt.

The problem presented to the Court in this case is whether the expenses by Hilton in the New York appraisal proceeding are to be classified as ordinary and necessary business expenses deductible under § 162[1] or as non-deductible capital expenditures described in § 263. As the Government states (U. S. Br. p. 11) there is no dispute between the parties as to the basic rules of Federal taxation, but the dispute centers around the application of these rules.

It is the taxpayer's position that its expenses in the appraisal proceeding are ordinary and necessary expenses deductible under § 162 because such expenses were not incurred to acquire a capital asset, but rather were incurred solely to determine the amount of the debt of Hilton to the dissenting shareholders, which debt was created when the dissenters filed their objection to the merger and demand for payment of the value of their stock with Waldorf. The previously accomplished acquisition of the dissenters' shares was not involved in the appraisal proceeding, said shares having been acquired when the debtor-creditor relationship was established, with all of the terms of such acquisition having been determined, including the purchase price, which was to be the fair value of the dissenters' shares. All of the attributes of stock ownership were lost to the dissenters prior to the appraisal and no unilateral act by them could restore title to the stock to them, nor change the terms of the acquisition.

Since the origin of the appraisal proceeding was in the

1. All references to section numbers, unless otherwise indicated, are to the Internal Revenue Code of 1954.

election of the dissenters to receive the fair value of their shares, and not in the merger, and since the character of that proceeding was only to determine such fair value, the appraisal proceeding was not functionally related to the merger, so as to have the rules relating to capitalization of merger expenses apply to the appraisal proceeding expenses. Rather, the established Federal income tax rules relating to the deductibility of expenses in determining the amount owed by one party to another are applicable to the instant case.

Many cases hold that where title is not in question but where merely the agreed amount of the acquisition price is in question, expenses incurred in determining that amount are deductible. The expenses are solely for the resolution of a dispute regarding the amount of a debt. Such a resolution gives the corporation no permanent benefit as does a merger or stock acquisition. The expenses are not capital expenses but rather are properly deductible.

I.

The Appraisal Proceeding Did Not Involve the Acquisition of Stock Nor Was It Functionally Related to the Merger.

The Government concedes (U. S. Br. p. 10) that the expenditures by Hilton in the appraisal proceedings having been made in a business context, are deductible unless they fall within the ambit of capital expenditures which are defined as "any amount paid . . . to increase the value of any property or estate." (§ 263). In this case, the touchstone in determining whether the expenditure increases the value of any property or estate is whether the expenditure is for "defending or perfecting title to property." (Treasury Regs. § 1.263 (a)-2(c)).

The Government also concedes (U. S. Br. p. 19) that this touchstone to the applicability of § 263 is absent in this

case by its admission that it agrees "with Hilton . . . in terms of the timing of title passage . . . [under] New York law." However, a further analysis of the origin and character of the New York appraisal proceeding is necessary to aid in evaluating the Government's arguments (1) that the origin and character of the New York appraisal proceedings are such as to bring Hilton's expenditures in the appraisal proceeding within the tax rules applicable to mergers under the rationale of the *Gilmore* case[2] and (2) that the expenses of the appraisal proceeding are a part of the acquisition cost of stock under the rationale of the *Winmill* case.[3]

Prior to the meeting of the shareholders of Waldorf to consider the merger of Waldorf into Hilton, certain shareholders of Waldorf filed *with Waldorf* their written objection to the merger (called a consolidation under New York law) and demanded payment for their stock. (R. 7, par. 18). The filing of the written objection to the merger and the demand for payment, had the following results under New York law as of the date of the vote by Waldorf shareholders approving the merger (December 28, 1953)[4]:

1. The dissenting shareholders lost their status and all of their rights as shareholders of Waldorf.[5]

2. The dissenting shareholders had the right only

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2. *United States* v. *Gilmore*, 372 U. S. 39 (1962).

3. *Helvering* v. *Winmill*, 305 U. S. 79 (1938).

4. N. Y. Stock Corp. Law § 21(1): "In the event that the stockholders of a corporation have taken action pursuant to section . . . ninety-one" (approved the merger) the New York statutory provisions for determination of the value of the stock of dissenting shareholders become effective. R. 7, par. 19.

5. N. Y. Stock Corp. Law § 21(6). Their status as shareholders could not be restored by withdrawing their demand for payment.

to receive the fair value of the Waldorf stock and thereby became creditors of Waldorf.[6]

The filing of the Certificate of Consolidation with the Secretary of State of New York on December 31, 1953[7] had the following results under New York law as of said date:

1. Hilton acquired all of the properties of Waldorf, subject to its liabilities, including Waldorf's liability to pay the dissenting shareholders the fair value of their stock.[8]

2. The approving Waldorf shareholders became shareholders of Hilton.[9]

3. Hilton retained the Hilton stock otherwise issuable to the dissenting shareholders.[10]

In summary, upon the approval of the merger by the Waldorf shareholders, the relationship between the dissenting shareholders and Waldorf became a debtor-creditor relationship, with Waldorf owing the dissenting share-

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6. N. Y. Stock Corp. Law § 21(6). Dissenting shareholders were required to submit their Waldorf stock certificates for the placing of a notation thereon of the fact of their demand for payment. No transferee of the notated certificate had any right under the certificate other than the right of the transferor for payment for his shares. N. Y. Stock Corp. Law § 21(8). However, if the merger had not been consummated, the dissenters' status as creditors would have terminated. N. Y. Stock Corp. Law § 21(6).

7. R. 7, par. 20.

8. N. Y. Stock Corp. Law § 85(1), § 91(6).

9. R. 23.

10. Such stock being "deemed to have been duly issued in accordance with the terms of such certificate [of consolidation] and reacquired by the . . . surviving corporation" to "be held or disposed of by it free of any preemptive rights of stockholders." N. Y. Stock Corp. Law § 21(7).

holders the value of their Waldorf stock.[11] Upon the consummation of the merger, Hilton assumed this liability of Waldorf, together with Waldorf's other liabilities. Hilton neither purchased or acquired the Waldorf stock owned by the dissenting shareholders. Thus, the acquisition, defense or perfection of title to the dissenters' shares by Hilton was not involved in the merger.

The statutory scheme in New York required Hilton and its new creditors to determine by agreement the amount of the debt owed to the dissenters[12] and pursuant thereto Hilton made a cash offer to the dissenting shareholders.[13] Had the dissenting shareholders accepted the offer, no appraisal proceeding would have been necessary, and Hilton's debt would have been liquidated by the payment of its offer.[14] However, the Hilton offer having been rejected, the dissenting shareholders began an appraisal proceeding under New York law to have the value of their stock determined.[15] The appraisal proceeding thus related functionally *only* to the determination of the amount owed by Hilton to the dissenting shareholders, and would not have been necessary had the parties agreed on the value of the stock. The dissenting shareholders initiated the appraisal proceedings[16] independently of the fact of the completion of the merger, and *solely* to obtain a judicial resolution of

11. *Beloff* v. *Consolidated Edison Company*, 300 N. Y. 11, 87 N. E. 2d 561 (1949); *Pikor* v. *Cinerama Products Corporation*, 25 F. R. D. 92 (E. D. N. Y. 1960); *Voege* v. *Sumatra Tobacco Corporation*, 241 F. Supp. 369 (1965); *Brasch* v. *Goldschmidt*, 199 A. 2d 760 (Del.) (1964); *Southern Production Co., Inc.* v. *Sobath*, 87 A. 2d 128 (Del.) (1952).

12. N. Y. Stock Corp. Law § 21(1).

13. R. 7, par. 21.

14. N. Y. Stock Corp. Law § 21(2), § 21(3).

15. R. 7, 8, par. 21. N. Y. Stock Corp. Law § 21(3).

16. Hilton also had the right to initiate the proceedings. N. Y. Stock Corp. Law § 21(3).

the amount of the debt from Hilton to them. Nothing in the appraisal proceedings, or the fruitless offer by Hilton leading up to them, was intended or could in any way affect the merger or title to the stock of the dissenting shareholders, and there was no functional relationship between the appraisal proceeding and the merger.

II.

The Rules Relating to Mergers Are Not Applicable to the Appraisal Proceeding as the Merger and the Appraisal Were Not Functionally Related.

Faced with the problem that § 263 cannot be applied to the appraisal proceeding when viewed alone, because the acquisition, defense or perfection of title was not involved in the appraisal proceeding, the Government argues (U. S. Br. pp. 14, 15) that the rules applicable to merger costs should be applied to Hilton's expenses in the appraisal proceeding. In support of its argument the Government cites the *Gilmore* case, and urges its application to the instant case, stating that the "origin" of the appraisal proceeding was in the merger (through the dissenters losing their rights as shareholders) and the "character" of the proceeding was the amount to be paid for a capital asset. In other words, since there would have been no appraisal proceeding if there had been no merger, the expenses of the appraisal proceeding are merger expenses.[17] The Government's argument is erroneous for two reasons: (1) It has misinterpreted the *Gilmore* case, and (2) it has not correctly characterized the functional relationship of the appraisal proceeding and the merger.

Mr. Gilmore was unable to deduct a portion of his litiga-

17. See *The Vermont Bank and Trust Company* v. *U. S.*, 296 F. Supp. 682, at 684-685 (D. C. Vt. 1969), which discusses this argument.

tion expenses in the California divorce proceeding because ***both*** the origin of the proceeding and the character of his wife's claim were personal. The origin of divorce litigation was in the personal marital relationship of the parties. The character of Mrs. Gilmore's claim was two-fold: (1) that she be granted a divorce and (2) that she be granted title to a greater portion of the community property than she would have otherwise been granted, based in both cases upon Mr. Gilmore's alleged infidelity. Both the divorce issue and the title issue were determined by the California court on the basis of the infidelity of Mrs. Gilmore during the marriage. Neither the origin or the character of the claim in the *Gilmore* case was in a business context relating to profit making activities, and other than the marital relationship of the parties, title to property was the issue in the litigation.

In contrast to the *Gilmore* case, the origin of the New York appraisal proceeding was clearly in a business context resulting from the failure of Hilton and the dissenting shareholders to agree on the amount owed to the dissenting shareholders.[18] The debtor-creditor relationship established first between Waldorf and the dissenting shareholders, and later assumed by Hilton, was the origin of the appraisal proceeding. This debtor-creditor relationship was created by the dissenting shareholders, and Hilton did not participate in the creation of the relationship nor acquire anything as a result of the creation of the relationship. Had the merger not been proposed, the debtor-creditor relationship could not have been established. However, the causal relationship between the merger and the appraisal proceeding is broken because the appraisal proceeding was a creature not of the merger, which in itself would not have caused the appraisal proceeding, but rather the objection and demand for payment of the dissenting

18. *Beerman* v. *United States*, 390 F. 2d 638 (C. A. 6, 1968).

shareholders, and the failure to agree on value, caused the appraisal proceeding. [19]

To characterize the appraisal proceeding initiated by the dissenting shareholders as originating in the merger is an extension of the holding of the *Gilmore* case beyond its intendment, which would cause many expenditures which may have been incurred by Hilton relating to Waldorf after the merger to be characterized as capital expenditures because they would not have been incurred but for the merger, although such expenses are clearly otherwise deductible as ordinary and necessary expenses. [20]

The California divorce proceedings in the *Gilmore* case settled property rights based upon the non-business actions of the parties. By contrast, the New York appraisal proceedings did not involve title to property, and the determination of value was based upon business considerations.[21] The New York appraisal proceedings cannot be characterized as part of the process of acquiring a capital

19. No indirect two step causal determination of origin was required in the *Gilmore* case, as the cause of the litigation was based only on the personal activities of the parties. In addition, the results of the litigation were also determined by their personal activities.

20. Such expenses could include: (a) increases in annual franchise taxes resulting from increased capitalization; (b) printing new stationery, invoices, etc. (c) the legal costs of an amendment to the pension plan of Hilton to allow the participation of the former employees of Waldorf who became employees of Hilton; (d) the installation of a new accounting system in the Waldorf-Astoria Hotel to permit the following of Hilton's procedures; (e) the integration of the Waldorf-Astoria Hotel into the Hilton reservation system; and (f) changes in Hilton's advertising brochures to include the Waldorf-Astoria Hotel. The generality of the application of this Court's decision in this case requires consideration of the classification of such expenses. See the discussion by the District Court on this point. (R. 35)

21. The evidence presented in the appraisal proceeding was directed only to the value of the Waldorf stock, while the evidence presented in the divorce proceeding related to the alleged marital infidelity of the parties.

asset, as all title questions were settled prior thereto, while who was to acquire or retain title to property was one of the principal issues in the *Gilmore* case state litigation.

For the Government to succeed in its argument based upon the *Gilmore* case, it must be held that both the "origin and character" of the proceedings are of a capital nature. The facts do not support a conclusion that either element is of a capital nature. The origin of the proceedings was a debtor-creditor relationship and the character of the proceedings was the determination of the amount of the debt.

Hilton, in the District Court, conceded (R. 33) that the cost of the services of Standard Research *before* the merger to prepare a study to guide Hilton in determining the fair basis of merger between Hilton and Waldorf was a merger cost because functionally a merger could not have been effected without the exchange ratio of stocks being agreed upon by the respective corporations.[22] The Government views this concession as affecting the issue before this Court (U. S. Br. pp. 24-25). However, the services of Standard Research *after* the merger with respect to its expert testimony in the appraisal proceedings were related solely to the determination of the value of the stock of the dissenting Waldorf shareholders on the day prior to approval of the merger.[23] The expenses for such services of Standard Research are clearly not related functionally to effecting the merger. Such expenses are as germane to the appraisal proceedings as the expenses of Hilton in payment of the court appointed appraiser's fee and the fees of the attorneys appearing in the proceeding. The fact that Standard Research performed services with respect to both the merger and the appraisal proceed-

22. R. 5-6, pars. 14, 15 and 16(b).

23. R. 8, par. 23.

ing in no way affects the classification for tax purposes of Hilton's expenses relating solely to the appraisal proceeding.

III.

The Appraisal Proceedings Did Not Result in Hilton Acquiring a Capital Asset.

The Government contends that Hilton's expenses in the appraisal proceeding were incurred as a part of the acquisition by Hilton of the dissenters' shares in Waldorf, and are therefore subject to the provisions of § 263 under the authority of the *Winmill* case. [24]

The services performed by the broker in the *Winmill* case, in bringing the buyer and seller together as the first step in a purchase of a capital asset, clearly "constituted part of the acquisition cost of the securities involved". But there is no analogy between Hilton's appraisal expense and the brokerage commission in the *Winmill* case. The appraisal proceeding was not necessary for the dissenting shareholders to cease to be shareholders of Waldorf and instead become its creditors, as this occurred upon the filing of their written objections and demand for payment for their stock. The determination of the amount owed by Hilton to the dissenting shareholders did nothing to add or subtract from the relationship of the dissenters to Hilton.

In discussing the *Winmill* decision, the Government cites many cases showing the application of the *Winmill* rationale. Most of the cases cited are not relevant to a decision in the instant case, as it is clear that title to a capital asset was the subject matter of the state court litigation and such element is absent in the New York appraisal proceeding. However, two of these cases may appear not to involve title defense or acquisition, and therefore require further analysis.

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24. *Helvering* v. *Winmill*, 305 U. S. 79 (1938).

One of the cases which may appear not to involve title acquisition, but which does, is the *Iowa Southern Utilities*[25] case, which has been characterized as being a case classifying legal expenditures incurred to reduce the cost of property already acquired.[26] However, this characterization is incorrect because in the stockholders' derivative suit in the Iowa courts there were two elements in the litigation: (1) it was necessary for the corporation to establish the liability of the stockholders and directors for wrongfully appropriating monies from the corporation in the guise of sales to the corporation,[27] and (2) it was then necessary for the corporation to establish the amount of such wrongful appropriation. Therefore, *Iowa Southern Utilities* is another case in which the gist of the state court action is the recovery of property, that is the assertion of title to money allegedly wrongfully taken by those defendants who breached their fiduciary duty, and falls within the long line of cases dealing with the capital nature of litigation expenses to acquire property. In this decision, the Eighth Circuit cited with approval the Tax Court statement that: "It is well settled that expenses of acquiring, perfecting or recovering title to property are non-deductible capital expenses" and the Eighth Circuit regarded *Spangler* v. *Commissioner*[28] as a particular significant authority, quoting the following language contained therein:

> "Since perfection of taxpayer's claim to ownership was the essence of the suit, the costs of the litigation

25. *Iowa Southern Utilities Co.* v. *Commissioner*, 333 F. 2d 382 (C. A. 8, 1964).

26. *Petschek* v. *United States*, 335 F. 2d 734 (C. A. 2, 1964).

27. *Des Moines Bank & Trust Co.* v. *Betchel*, 243 Iowa 1007, at 1015, 51 N. W. 2d 174, at 180 (1952). See also description of the nature of the litigation by the Eighth Circuit in the *Iowa Southern Utilities case*, 333 F. 2d 382 at 383 (1964).

28. 323 F. 2d 913 at 920 (C. A. 9, 1963).

were capital expenditures and, under the authority cited, were not expenses deductible from ordinary income."

Another case cited by the Government which does not appear to involve title defense and acquisition is *United States* v. *Morton*,[29] where it was held that attorneys fees incurred for the collection of fire insurance proceeds were not deductible by a corporation in the process of a complete liquidation. However, the analysis of the court in determining when title passed for the purpose of determining the applicability of § 337 resulted in a determination that a fictional sale or exchange occurred because of the provisions of the Internal Revenue Code relating to involuntary conversions[30] at a time not earlier than the date that the offer of the insurer in settlement of the claim resulting from the fire loss was accepted by the insured. Thus, on the basis that title was an integral part of the proceeding for the collection of the fire insurance indemnity, the attorneys fees for such collection were held to be subject to the rules of § 263. But unlike fire insurance collection proceedings, title is not involved in the instant case, so the reasoning in the *Morton* case is inapplicable.[31]

The case *Usry* v. *Price*, 325 F. 2d 657 (5th Cir. 1963) is illustrative of the importance of the absence of the acts of defending or acquiring title in determining deductibility. The *Price* case involved the deductibility of legal fees in the second case in which the State of Louisiana challenged

29. 387 F. 2d 441 (C. A. 8, 1968).

30. § 1033.

31. The *Morton* case relies heavily on *Towanda Textiles, Inc.* v. *United States*, 180 F. Supp. 373 (Ct. Cl. 1960) involving the same issue. However, certain cases are *contra* and hold expenses to determine fire loss amounts deductible. *Ticket Office Equipment Co.* v. *Commissioner*, 20 TC 272, Acq. 1953-2 Cum. Bull. 6, aff'd per curiam, 213 F. 2d 318 (C. A. 2, 1954) and *U. S.* v. *Pate*, 254 F. 2d 480 (C. A. 10, 1958).

taxpayer's title to and right to income from certain oil wells. In this case, the Fifth Circuit said that it was not its province to adjudicate the issue of title but rather to decide whether the issue had been settled and if so at what time. The Court held that since the issue of title had been adjudicated in the first Louisiana case and was *res judicata* in the second case, the attorney's fees in the second case were deductible under § 212.[32]

What the Second Circuit said in *Petschek* v. *United States*[33] is equally applicable to the New York appraisal proceeding:

> ". . . title had been lost long ago and the taxpayer had no chance of regaining it."

Such was the situation of the dissenting shareholders in the instant case.

There are three lines of cases decided by lower courts involving proceedings which have many elements in common with the New York appraisal proceeding in the instant case and therefore are relevant to the application of the *Winmill* case rationale to the New York appraisal proceeding:

> 1. The cases involving legal expenses in a condemnation proceeding, which have generally held that such expenses must be capitalized;[34]

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32. The Government agrees with this analysis of *Usry* v. *Price*, *supra*, but calls the case peculiar. (U. S. Br. pp. 17, 18, n. 12) Perhaps it is the case with peculiar circumstances that best illustrates a legal principle.

33. 335 F. 2d 734 at 736 (C. A. 2, 1964). The Second Circuit is said to have rendered an "able opinion" in the case in 4A *Mertens, Law of Federal Income Taxation* Section 25 A. 16, page 48 (1966 Rev. Ed.) However, taxpayer does not contend this is relevant nor does taxpayer consider references to *Mertens* made by the Government in its brief as relevant.

34. *Isaac G. Johnson & Company* v. *United States*, 149 F. 2d 851 (C. A. 2, 1945) and three cases cited therein similarly holding. But see *L. B. Reakirt*, 29 BTA 1296 (1934), *aff'd per curiam*, 84 F. 2d 996 (C. A. 6, 1934), where expenses of successfully resisting illegal condemnation were held deductible.

2. The cases involving legal expenses in the recovery of the value of property confiscated by foreign governments, which have held such expenses to be deductible;[35] and

3. The cases involving legal expenses in the determination of purchase price in private contracts under which the sale has been consummated, which have held such expenses to be deductible.[36]

The common elements in all these cases are that an acquisition has occurred or will occur, either voluntarily or by unilateral public action, and the purchase price is determined, either by agreed formula or as fair value. The New York appraisal proceeding falls somewhere in between private contracts on one hand, and condemnation and confiscation proceedings on the other hand, being quasi-public and quasi-private, in that the rules for the taking of the stock are set forth by the state, but the stockholder must elect to come within these rules by objecting and demanding payment for his stock.

However, the elements of difference are significant:

(1) In private contract and confiscation cases, the acquisition occurs *prior* to the proceeding to determine fair value or the amount of the purchase price under the agreed formula, while in condemnation cases the time of the acquisition varies, because of the variety of state laws under which condemnation proceedings may occur. For example, title may pass be-

35. *Petschek* v. *United States*, 335 F. 2d 734 (C. A. 2, 1964); *Commissioner* v. *Speyer*, 77 F. 2d 824 (C. A. 2, 1935), *certiorari* denied, 296 U. S. 631; *Commissioner* v. *Ullmann*, 77 F. 2d 827 (C. A. 2, 1935), certiorari denied, 296 U. S. 631; see also *Ruoff* v. *Commissioner*, 277 F. 2d 222 (C. A. 3, 1960).

36. *Naylor* v. *Commissioner*, 203 F. 2d 346 (C. A. 5, 1953); *William C. Atwater & Co.*, 10 TC 218 (1948) (Acq. 1948-1 Cum. Bull. 1).

fore the proceeding to determine the amount of the award commences, during such proceeding, or only after the condemnation award is determined.[37]

(2) Condemnation cases are also distinguishable from the other cases because the award granted by a court is not always based solely on the value of the property taken. Condemnation awards sometimes include, for example, (a) compensation for damages to property not taken by the condemning authority from the injured party in the case of a partial taking (recovery of capital) and (b) damage to the business of the injured party consequentially caused by the nature of a particular taking, when the business itself is not acquired by the condemning authority (loss of income).[38] However, in contrast, confiscation proceedings, private contracts and the instant appraisal proceeding require solely the determination of value.

For these reasons, condemnation proceedings are not completely analogous to private contract and confiscation cases, or the New York appraisal proceeding, and thus their precedent value in the instant case is greatly diluted. Further, the cases deciding the tax classification of expenses in a condemnation proceeding have not recognized or analyzed the various elements of a condemnation award, or the significance of the various times of acquisition, thus weakening any precedent value they may have.[39]

37. 3 *Nichols on Eminent Domain*, § 8.5(1) and (2), (3rd Ed. 1965). This is also true of proceedings to determine the fair value of stock under the variety of state laws and situations which give an objecting shareholder who demands payment for his stock the right to appraisal. See footnotes 48 and 51 *infra*; U. S. Br. p. 23, n. 7; Br. in Opp. p. 12.

38. 64 American Law Reports, 1513.

39. There appears to have been no intensive analysis of the nature of various condemnation proceedings, and any such analysis is absent as well in *Isaac G. Johnson & Co.* v. *United States*, 149 F. 2d 851 (C. A. 2), decided in 1945 before the great body of law

Thus, in the difficult application of § 263, three lines of cases provide conflicting authority, the confiscation and private contract cases weighing in favor of deduction, and the distinguishable condemnation cases weighing in favor of capitalization. It is the position of Hilton that the law is clearer and better considered in the private contract and confiscation cases, and in addition, such cases are more like the instant case than the condemnation cases, which have elements in addition to determination of value which have been neither recognized nor analyzed by the lower courts.

In the only Supreme Court case dealing with the tax effect of a condemnation (in an area not relevant here), *Kieselbach* v. *Commissioner*, 317 U. S. 399 (1942), the condemning authority first took title to the property and then the proceeding to determine the award was commenced, which makes that condemnation proceeding most directly relevant to the New York appraisal proceeding in the instant case. In the *Kieselbach* case, the Supreme Court held that ". . . the purchase price was settled as of January 3, 1933, when the property was taken over." In the same manner, the purchase price of the Waldorf shares was settled as of the date the dissenters filed their written objection and demand for payment with Waldorf. In the instant case the amount of the purchase price (fair value of Waldorf shares) and all other terms of the acquisition were set forth in the state statute, and *nothing* remained to be agreed upon by the parties as a *condition* to the acquisition. The New York court was not determining value

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in the area which is involved in this case was developed. The only two cases which have determined the classification of legal expenses in condemnation cases since 1945 are Tax Court Memorandum Decisions which did not even cite *Johnson* and contain very little analysis. *The Columbus Die, Tool and Machine Company*, 11 CCH Tax Ct. Mem. 1053, 1066 (1952); *T. J. Foster*, 25 CCH Tax Ct. Mem. 1390, 1421 (1966).

as a *requisite* to consummate an acquisition, as parties would in negotiating a sale. An acquisition had occurred, and only the amount of Hilton's liability to its creditors was to be determined in the New York appraisal proceeding.

It is the fact that all of the terms of the acquisition of the Waldorf shares had been settled by state law, and that the New York appraisal proceeding did nothing to restate these terms, which removes the expenses of the New York appraisal proceeding from the *Winmill* rationale as "a part of the acquisition cost". The problem was not to reach mutually satisfactory or binding terms of sale. Because of this, the instant case does not fall within the factual situation decided in *Munson* v. *Mac Ginnes*,[40] but rather within the factual situation decided in *Naylor* v. *Commissioner*.[41] The *Munson* case involved legal fees incurred in securing additional consideration for the sale of stock because the original purchase was induced by fraud and the Third Circuit commented at page 335 concerning this factual situation as follows:

> "More analytically, if terms of sale have been agreed and subsequent controversy concerns no more than the enforcement of these terms against a defaulter the problem is one of 'collection'. [Citing *Naylor* v. *Commissioner*] If the problem is to reach mutually satisfactory or binding terms of sale, the problem is one of disposing of the property, not of collection, and the question of capitalization must be faced."

It is upon this distinction that this case turns in favor of the deductibility of Hilton's appraisal expenses, for the *Naylor* case is hardly distinguishable from the instant

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40. 283 F. 2d 333 (C. A. 3, 1960), cert. den. 364 U. S. 880.

41. 203 F. 2d 346 (C. A. 5, 1953).

case.[42] In the *Naylor* case an option to purchase the stock of taxpayer at the "net asset value" thereof was exercised, but a dispute arose as to the "net asset value" of the stock. The taxpayer, after the exercise of the option, and the creation of an enforceable contract of sale, retained a lawyer to negotiate, and if necessary sue, for what the taxpayer deemed to be the correct price to be paid for his stock based upon "net asset value". The lawyer obtained payment for the stock of the taxpayer of an amount $140,000 greater than stated by the optionee in the exercise of the option, and the amount paid to the lawyer for his services was held to be deductible under § 212,[43] because the taxpayer was incurring his legal expenses only for an enforcement of a claim, resulting from an acquisition which had already occurred.[44]

Thus, in the *Naylor* case, unlike in the *Munson* case,[45] the terms of the acquisition, including purchase price, had been agreed to by the parties, and the services of the attor-

42. The Government contends that *United States* v. *St. Joe Paper Co.*, 284 F. 2d 430 (C. A. 5, 1961) represents the law of the Fifth Circuit, rather than the *Naylor* case (U. S. Br. p. 16 n. 11). However, there does not seem to be any relationship between the two cases. The *St. Joe Paper* case involved the deductibility of the legal fee incurred in the *process* of a receivership proceeding whereby title to stock was *acquired* by the taxpayer in a railroad company in which the taxpayer bought bonds in order to obtain a stock interest. The legal proceeding in the *St. Joe Paper* case involving the acquisition of title to stock is in no way comparable to the *Naylor* case where acquisition of stock was not involved, but rather the determination of purchase price was the issue with respect to an acquisition which had already occurred.

The Government's comment on the *Naylor* case being questioned by the Ninth Circuit in the *Spangler* case is covered in this brief at pages 21-22, dealing with a similar reference by the Government to the *Heller* case.

43. Formerly § 23(a)(2) of the Internal Revenue Code of 1939.

44. *William C. Atwater & Co.*, 10 TC 218, 248 (Acq. 1948-1 Cum. Bull. 1).

45. n. 40 *supra*.

ney were not for the purpose of reopening the terms of acquisition. So it was with the New York appraisal proceeding, which was premised on an acquisition at fair value, and did nothing to reopen the terms of acquisition. It is here that lack of analysis of the possible variety of condemnation cases in the lower courts fails to resolve the basic question concerning Hilton's expenses in the appraisal proceeding.[46]

The Government correctly states that capital expenditures are usually defined as those outlays made to acquire a tangible or intangible asset or benefit with a useful life of more than one year, and the costs incurred in a reorganization, because they have benefit beyond one year, are within this rule (U. S. Br. pp. 10, 11). This rule is important in determining the correct tax classification of the expenditures made by Hilton with respect to the appraisal proceeding. The purpose of the appraisal proceeding was not to confer a benefit upon Hilton with a useful life beyond one year, as the benefits of the merger were unrelated to the appraisal proceeding and had been conferred upon Hilton by the laws of the State of New York upon the filing of the Certificate of Consolidation and the acquisition by Hilton of the properties of Waldorf. Hilton's only purpose in the appraisal proceedings was to keep its liability to the dissenting Waldorf shareholders which it had assumed as a result of the merger to a minimum, a purpose as ordinary and necessary to its everyday activities as resisting what it considers unreasonable demands of any other creditor of Waldorf or Hilton holding a claim against it. There is no distinction between either activity in terms of continuing benefit, as both activities could be characterized as having a benefit beyond one year, as the corporate treasury may be enriched in both cases. To characterize Hilton's expenditures in the appraisal proceed-

46. n. 39 *supra*.

ing as having a continuing benefit beyond one year is to stretch the concept beyond reason and its intendment.[47]

IV.

The Lower Court Cases Holding Expenses of an Appraisal Proceeding Deductible Are Correct.

In addition to the cases before this Court, the problem of tax classification of appraisal expenses have been the subject of many cases in lower courts, and all but one of these cases have held such expenses deductible.[48]

Uncomfortable with the preponderance of cases in favor of taxpayers, the Government states that *Heller* does not represent the law of the Ninth Circuit and that the Ninth Circuit specifically disapproved of its *Heller* opinion in *Spangler* v. *Commissioner*.[49] This is not a fair analysis of the *Spangler* case. To support its position the Government relies upon footnote 15 on pages 919-920 of the *Spangler* decision (U. S. Br. pp. 15-16). The statement notated by the Ninth Circuit was:

"The gist of the controversy between taxpayer and

47. *Chicago Dock & Canal Co.*, 32 BTA 231 (1935) aff'd *per curiam*, 84 F. 2d 288 (C. A. 7, 1936), holding as deductible the legal expenses incurred in successfully resisting the imposition and amount of a special assessment having a continuing benefit to real estate.

48. Cases favoring taxpayer: *Heller* v. *Commissioner*, 147 F. 2d 376 (C. A. 9, 1945), affirming 2 TC 371, certiorari denied, 325 U. S. 868 (shareholder expense upon merger); *Smith Hotels Enterprises, Inc.* v. *Nelson*, 236 F. Supp. 303 (E. D. Wisc. 1964) (corporate expense upon sale of assets); *The Vermont Bank and Trust Company* v. *United States*, 296 F. Supp. 682 (D. C. Vt. 1969) (corporate expenses on merger); *Stempfel* v. *United States*, 23 AFTR 2d 69-685 (M. D. Tenn. 1969) (stockholder expenses on merger). The case favoring Government: *Boulder Building Corp.* v. *United States*, 125 F. Supp. 512 (W. D. Okla. 1954) (corporate expenses on extension of corporate charter).

49. 323 F. 2d 913 (C. A. 9, 1963).

> the managing officers in the state court litigation was the ownership of the stock."

This is to be contrasted with the finding of fact upon which it based its *Heller* decision:

> "The Tax Court in its finding of fact found that in this litigation the taxpayer was not defending or asserting its title."[50]

Thus, there was no reason for the Ninth Circuit to disapprove of its *Heller* decision in *Spangler*, as the cases were distinguished on their respective facts. Indeed, the Ninth Circuit did not disapprove of the *Heller* case, as footnote 15 reads:

> "The present case is thus distinguishable from those in which it has been concluded that the primary issue was not ownership but rather the right to possession [citations] . . . , or the price to be paid for property . . . [citing *Naylor* and *Heller*]. Moreover, as we have suggested, to the extent that these cases . . . assume that section 23(a)(2) [now section 212] created a new category of deductions . . . we think they are based upon an unsound premise."

Footnote 15 is more properly interpreted as an approval by the Ninth Circuit of its *Heller* decision as the *Heller* decision does not assume any "new category of deductions".

The Government tries to distinguish the cases favorable to the taxpayer which rely on the "primary purpose" test, stating that in *Hilton* there was no element other than title acquisition involved in the New York appraisal proceeding (U. S. Br. p. 17). Hilton agrees that the instant case is indeed distinguishable from the cases applying the "primary purpose" test, because *only the amount owed* by Hilton to the dissenters based upon the value of their Waldorf shares was at issue in the New York appraisal

50. 147 F. 2d 376 at 377 (C. A. 9, 1945).

proceeding. Hilton further does not seek to come within the umbrella of the "primary purpose" test for this reason. However, Hilton agrees with the petitioner in the *Woodward* case (No. 412) that the "primary purpose" test is relevant in classifying appraisal expenses in proceedings which also involve an element of title.

The circumstances under which appraisal proceedings occur are varied,[51] and with respect to events which cause appraisal, the rules of state law may differ,[52] and therefore passage of title may occur at different times in relationship to the appraisal proceedings. The Government argues since all appraisal proceedings have one element in common (determination of value) that all appraisal proceedings should be treated in the same manner, and such expenses should be capitalized without determining the purpose of the proceeding (U. S. Br. p. 22). But such an argument cuts both ways, as it may be argued that since all appraisal proceedings involve determination of value, the expenses of all such appraisal proceedings should be deductible. This would bring as much simplicity and certainty in the administration of the Federal income tax law as the Government's position.

However, Hilton believes that neither position is valid. Courts have been successfully applying the "primary purpose" test in determining the application of § 263 since 1913, and there is nothing unique in an appraisal proceeding which would preclude the application of the test by looking to the underlying substantive rights of the parties under state law, and determining the primary issue being litigated in the state court proceeding. Fairness in the administration of the Federal income tax laws should

51. Examples are: (1) merger, (2) consolidation, (3) exchange of corporate shares, (4) sale of all or substantially all of the assets of a corporation, and (5) continuation of corporate charter.

52. U. S. Br. p. 23, n. 17; Br. in Opp. 12.

be a more important goal than simplicity in its administration. To the extent that the issue or the transaction involved in appraisal proceedings differ, each should be treated in accordance with established tax principles.[53]

The Government argues that such a position by this Court would allow refinements of title under state law to govern Federal tax consequences (U. S. Br. p. 22). But in the cases cited by the Government, it was found there were no substantive state law distinctions for Federal income tax purposes in determining when income is realized or the nature of such income, and these cases do not deal with § 263, which by its terms deals with property rights, which can only be determined by state law.

In his administration of the tax laws the Commissioner of Internal Revenue must make determinations of state law, and this is most appropriately demonstrated by Revenue Ruling 68-285[54] involving an appraisal of the value of dissenters' stock.[55] Surely the Government can-

53. The Government states (U. S. Br. p. 18) that Hilton "... seems to agree the *Woodward* was correctly decided . . ." However, Hilton neither agrees nor disagrees with the *Woodward* decision, and has not addressed itself to that problem in this brief. The distinctions made between the facts in this case and in the *Woodward* case were made in Hilton's Brief in Opposition solely for the purpose of attempting to demonstrate there was no conflict between the Circuits.

54. 68-1 Cum. Bull. 147.

55. Under a state banking law allowing dissenters rights for the payment of the value of their stock, Bank X acquired in exchange for its stock, all of the stock of Bank Y, other than the 25% of the stock of Bank Y owned by dissenting shareholders. The transaction was held to be a reorganization under § 368(a)(1)(B) which has two requirements germane to the ruling: (1) the stock of Bank Y had to be acquired solely for voting stock of Bank X and (2) after the exchange Bank X had to own at least 80% of the stock of Bank Y in order to meet the control requirements of § 368(c).

Bank Y established an escrow fund prior to the exchange from which payments of cash to the dissenters were made both before

not contend that the Commissioner may make determinations of state law in appraisal proceedings to determine substantive tax questions, but courts should not.

The Government excludes from its statement concerning refinements of title under state law those cases where "the revenue statutes explicitly or implicitly so provide." (U. S. Br. p. 22). Issues to be decided under § 263 must refer to state law to determine whether there is a defense or perfection of title and there is an explicit reference in the statute to the increase in value of an estate, which can only be determined under state law. All of the "primary purpose" test cases must by their nature rest on an analysis of state law. The nature of corporate powers and status of individuals as stockholders have been determined by courts in deciding substantive tax consequences.[56] Thus, while the Government's contentions concerning state law

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and after the exchange, and any cash not so expended was to be returned to Bank Y (then a wholly owned subsidiary of Bank X). Under these circumstances Bank X was determined *not* to have acquired any Bank Y stock for cash, and thus met the solely for voting stock requirement. The Revenue Ruling notes that this requirement would not have been met if "the acquiring corporation pays the dissenting shareholders or reimburses the acquired corporation for its payment to the dissenting shareholder."

A further analysis of state law was required of the Commissioner to determine whether the 80% control requirement was met. Here the determination was that since "under the state banking law, each dissenting shareholder . . . ceased to have any shareholder rights except to the right to demand payment for the fair market value of his shares, [T]herefore immediately after the exchange, X owned all of the outstanding Y stock."

Thus detailed analysis of state law was required to determine substantial income tax consequences, and this analysis resulted in a determination that Bank X did not acquire any stock of Bank Y, under the appraisal procedure discussed in the ruling.

56. For example, see *Stevens Brothers Foundation, Inc.* v. *Commissioner*, 324 F. 2d 633 (C. A. 1963); *Collateral Equities Trust*, 39 BTA 834 (1939) (Acq. 1939-1 Cum. Bull. 7), which cases decided the application of the personal holding company tax based upon state law determinations of a corporation's powers and when a person becomes a stockholder.

are true, they are inapplicable to the cases before this Court.

In summary, since Hilton did not acquire a capital asset as a result of the New York appraisal proceeding, and since there is no functional relationship between the appraisal proceeding and the merger so as to make rules concerning mergers applicable, the expenses of Hilton in the appraisal proceeding are deductible as an ordinary and necessary expense under § 162.

CONCLUSION.

The decision of the Seventh Circuit should be affirmed.

Respectfully submitted,

MILTON A. LEVENFELD,
BURTON W. KANTER,
RICHARD M. KATES,
10 South LaSalle Street,
Chicago, Illinois 60603,
Attorneys for Respondent.

February 14, 1970.

APPENDIX.

New Stock Corporation Law, 58 McKinney's, Consolidated Laws of New York, Annotated:

§ 21. *Determination of value of stock of objecting stockholder.*

1. In the event that the stockholders of a corporation have taken action pursuant to sections . . . ninety-one . . . and if any stockholder has objected to such action and demanded payment for his stock as provided in section . . . ninety-one . . . the corporation . . . within ten days after the last day on which a demand for payment might have been made, shall mail by registered mail to such objecting stockholder or deliver personally to him a written offer to pay for such stock in cash at a price deemed by the corporation to be the value thereof; and an offer so made to any such objecting stockholder shall also be made on the same terms and conditions and at the same price per share to all such objecting holders of shares of the same class of stock . . .

• • • • •

3. . . . If the objecting stockholder shall fail to accept an offer from the corporation within twenty days after the mailing or delivery thereof, . . . such stockholder or the corporation may petition the supreme court . . . to determine the value of such stock . . .

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4. . . . The court shall . . . proceed to determine the value of their stock, or shall appoint an appraiser to determine such value . . . For all the purposes of this section, such value shall be determined as of the close of business on the day before the taking of the stockholders' vote on the action to which objection was made, excluding any appreciation or depreciation di-

rectly or indirectly consequent upon such action or the proposal thereof . . .

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6. Any stockholder demanding payment for his stock shall have no right to receive any dividends or distributions payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights of a stockholder of the corporation with respect to such stock, except the right to receive payment for the value thereof as in this section provided; and no such demand may be withdrawn unless the corporation shall consent thereto . . . if the action to the taking of which objection was made shall be abandoned or rescinded, the status of such stockholder as a stockholder in the corporation thereupon shall be restored . . .

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7. . . . if payment for the stock of an objecting stockholder shall have been demanded in consequence of action taken on a merger or consolidation pursuant to sections eighty-five, eighty-six or ninety-one, the shares or other securities of the resulting or surviving corporation into which the shares of the objecting stockholder would have been converted had no objection been made shall, unless the certificate of merger or consolidation shall otherwise provide, be deemed to have been duly issued in accordance with the terms of such certificate and reacquired by the resulting or surviving corporation, and may be held or disposed of by it free of any preemptive rights of stockholders . . .

• • • • •

8. Within twenty days after the last day on which a demand for payment might have been made, each stockholder demanding payment, unless the offer of the corporation to pay therefor shall have been accepted, shall submit his stock certificate or certificates to the corporation for notation thereon of the fact of such demand; and any stockholder who shall fail so to

do shall not be entitled to the relief by this section provided unless a court of competent jurisdiction, for good and sufficient cause shown, shall otherwise direct. Upon any subsequent transfers of such stock on the books of the corporation prior to payment by the corporation of the value thereof, as herein provided, the new certificate or certificates issued therefor shall bear a similar notation, together with the name of the original objecting holder of such stock, and until such payment shall have been made, no transferee of any such stock shall acquire any rights of any character whatsoever by reason thereof except the rights of the original objecting stockholder.

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§ 91. *Consolidation of domestic with foreign stock corporations.*

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7. Any stockholder of a domestic corporation included in such consolidation, not voting in favor thereof, may object to such consolidation and demand payment for his stock, at any time prior to the vote . . . The objecting stockholder or the corporation shall have the right to have such stock appraised and paid for in the manner provided, and subject to the conditions imposed by section twenty-one . . .

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SUPREME COURT OF THE UNITED STATES

No. 528.—October Term, 1969

United States, Petitioner, v. Hilton Hotels Corporation. } On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[April 20, 1970]

Mr. Justice Marshall delivered the opinion of the Court.

This is the companion case to *Woodward* v. *Commissioner, ante,* and presents a similar question involving the tax treatment of appraisal litigation expenses.

In 1953 taxpayer Hilton Hotels Corporation, which owned close to 90% of the common shares of the Hotel Waldorf-Astoria Corporation, determined to merge the two companies. Hilton retained a consulting firm to prepare a merger study to determine a fair rate of exchange between Hilton stock and Waldorf stock. After this study was completed, on November 12, 1953, Hilton and Waldorf entered into a merger agreement under which Hilton would be the surviving corporation, and 1.25 shares of Hilton stock would be offered for each outstanding Waldorf share not already held by Hilton. On December 28, Hilton voted its Waldorf stock to approve the merger by the requisite majority. Prior to the vote, the holders of about 6% of the Waldorf shares had filed with Waldorf their written objections to the merger, and demanded payment for their stock, pursuant to § 91 of the New York Stock Corporation Law.

On December 31, 1953, Hilton filed the merger agreement and the certificate of consolidation with the Secretary of State of New York, thus consummating the merger under New York law. On January 7, 1954, Hilton made a cash offer to the dissenting Waldorf shareholders, which they rejected. The dissenters then began appraisal proceedings in the New York courts, pursuant to § 21 of the New York Stock Corporation Law.

Between January and May 1954, Hilton asked its consulting firm to value the Waldorf stock as of December 27, 1953, the day prior to the Waldorf shareholders' vote approving the merger. Hilton also obtained the services of lawyers, and other professional services, in connection with the appraisal litigation. The appraisal proceeding was finally terminated in June 1955, when the state court approved a settlement agreed to by the parties.

Hilton deducted the fees paid to the consulting firm, and the cost of legal and other professional services arising out of the appraisal proceeding, as ordinary and necessary business expenses under § 162 of the Internal Revenue Code of 1954. The Commissioner of Internal Revenue disallowed the deduction on the ground that the payments were capital expenditures. Hilton paid the tax and sued for a refund in the District Court. In the course of that suit, Hilton conceded, and the court held, that the payments to the consulting firm for the pre-merger determination of fair value was a nondeductible capital outlay. But the District Court held that the fees and costs related to the post-merger appraisal proceeding itself were deductible. 285 F. Supp. 617 (D. C. N. D. Ill. 1968). The Court of Appeals affirmed, 410 F. 2d 194 (C. A. 7th Cir. 1969), and we granted certiorari, 396 U. S. 954 (1969). We reverse.

The Court of Appeals recognized that expenses of acquiring capital assets are capital expenditures for tax

purposes. However, the court believed that the "primary purpose" tests of *Rassenfoss* v. *Commissioner,* 158 F. 2d 764 (C. A. 7th Cir. 1946), should be applied to determine whether the appraisal proceeding was sufficiently related to the merger or the stock acquisition. Noting that "the proceeding was not necessary to the consummation of the merger nor did it function primarily to permit the acquisition of the objecting holders' shares," the court found that "the paramount purpose of the appraisal proceeding was to determine the fair value of the dissenting stockholders' share in Waldorf." 410 F. 2d, at 197.

As we held in *Woodward, supra,* the expenses of litigation which arise out of the acquisition of a capital asset are capital expenses, quite apart from whether the taxpayer's purpose in incurring them is the defense or perfection of title to property. The chief distinction between this case and *Woodward* is that under New York law title to the dissenters' stock passed to Waldorf as soon as they formally registered their dissent, placing them in the relationship of creditors to the company for the fair value of the stock,[1] whereas under Iowa law passage of title was delayed until after the price was settled in the appraisal proceeding.[2]

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[1] Section 91 (9) of the New York Stock Corporation Law provides that a corporate consolidation becomes effective upon the filing of the requisite certificate. Section 21 (6) of the same law provides that as of the time of a merger vote, a dissenting shareholder loses all rights as such, except the right to receive payment for the value of his shares.

[2] Iowa Code Ann. § 491.25 provides that majority shareholders voting for renewal "shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal . . . ." There is no intimation in the statute itself, nor in Iowa cases construing it cited by petitioners in *Woodward, ante,* that dissenters lose any of their rights as shareholders, or that title passes to the majority shareholders, prior to the actual purchase of the dissenters' shares.

This is a distinction without a difference. The functional nature of the appraisal remedy as a forced purchase of the dissenters' stock is the same, whether title passes before or after the price is determined. Determination and payment of a price is no less an element of an acquisition by purchase than is the passage of title to the property. In both *Woodward* and this case, the expenses were incurred in determining what that price should be, by litigation rather than by negotiation. The whole process of acquisition required both legal operations—fixing the price, and conveying title to the property—and we cannot see why the order in which those operations occurred under applicable state law should make any difference in the characterization of the expenses incurred for the particular federal tax purposes involved here.

Hilton also argues that the appraisal costs cannot be considered as its own capital expenditures, since Waldorf acquired the shares (on December 28) before the merger (on December 31). This argument would carry too far. It is true that title to the dissenters' stock passed to Waldorf before that corporation was merged into the surviving corporation, Hilton. But the stock was never paid for by Waldorf; rather Hilton assumed all of Waldorf's debts under the merger agreement, and finally paid for the stock after the appraisal proceeding was settled. If Waldorf's acquisition of the minority stock interest was not a capital transaction of Hilton's, then Hilton's payment for the stock itself, as well as the expenditures made in fixing that price, would lose its character as a capital expenditure of Hilton's. But Hilton concedes that the payment for the stock was a capital expenditure on its part. The debts which Hilton inherited from Waldorf retained their capital or ordinary character through the merger, and so did the expenditures for fixing the amount of those debts.

In short, the distinctions urged between this case and *Woodward* are not availing. The judgment of the Court of Appeals is reversed, and the case is remanded to the District Court with directions to dismiss the complaint.

It is so ordered.